Financial reporting quality: An exploratory study of small- and mid-cap entities listed on the JSE

A research thesis submitted by

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Table i: List of defined terms

Abbreviation	Full Term
AIS	Accounting Information Systems
AFS	Annual Financial Statements
CA(SA)	Chartered accountant (South Africa)
CFA	Chartered financial analyst
EBITDA	Earnings before interest, tax, depreciation and amortisation
HQ	High-quality
IASB	International Accounting Standards Board
IR	Integrated Reporting
I.T.	Information technology
JSE	Johannesburg Stock Exchange
Large cap	Largest JSE listed firms by market capitalisation
LQ	Low-quality
Small-mid cap	Small to medium sized JSE listed firms by market capitalisation

The fundamental challenges small- and mid-cap firms are facing in producing high-quality financial statements

High-quality financial statements are becoming increasingly difficult to prepare as business and the IASB's standards evolve and become increasingly complex. This may leave small- and mid-cap firms vulnerable to being ill-equipped to produce high-quality financial statements based on their limited resources and dependencies. Minimal research has focused on the components that contribute to attaining high-quality financial statements at small- and mid-cap firms. The research that has focused on this has been predominately centered around large-cap firms, while little attention has been allocated to that of the small- and mid-cap firms. Small- and mid-cap firms comprise the majority (in number) of the companies listed on the JSE and contribute a significant portion of growth and employment to South Africa. It is important to address this gap in research so that structures can potentially be put into place to support these companies and aid their success. An exploratory qualitative research method was employed due to the limited availability of prior research. Data was obtained through semi-structured, open-ended interviews with senior financial executives at small- and mid-cap JSE listed entities. Further interviews were conducted with auditors, regulators, and academics in relation to their interactions and perceptions of the financial reporting quality at small- and mid-cap firms. It appears that small- and mid-cap firms may be disadvantaged by the limited resources they have access to. If so, this tends to adversely affect their ability to implement effective corporate governance and particularly obtain financial management with high expertise, adversely affecting the quality of their financial statements. Conversely, there are factors that may contribute to decreasing the challenges they face. Small- and mid-cap firms often have finance teams with longer tenures and inherently less complex processes and reporting. This allows staff to understand the business intrinsically, facilitating with the financial reporting process.

1. Introduction

In a perfect world, all users of financial statements would have access to high-quality financial statements. In reality, the quality of financial reports varies greatly (Robinson et al., 2015). Small to medium sized JSE listed firms (defined by market capitalisation as per Appendix 5) may face increased challenges in terms of preparing high-quality financial statements. Small- and mid-cap entities, in comparison to their larger counterparts, often lack: (1) financial resources, (2) latest information technology and (3) attracting and maintaining quality human capital (Yoshino and Taghizadeh Hesary, 2016).

There is little recent research on the factors contributing to better quality financial reporting on small- and mid-cap firms. The research which exists is mainly focused on large-cap firms while small- and mid-cap firms have been over-looked (Lee and Yeo, 2016, Atkins and Maroun, 2015). Globally, investors and analysts tend to focus capital and attention onto the large-cap firms. This trend is indifferent in South Africa, with the JSE Top 40 being the primary interest of most local investors. The small- and mid-cap firms are largely underappreciated and attract minimal institutional interest (Gavaza, 2021). The current research addressed this gap in literature. It aimed to identify and understand the challenges that small- and mid-cap firms face when preparing their financial reports.

It is important to address this gap as these companies play a pivotal role in helping developing economies progress (Fooladi and Nikzad Chaleshtori, 2011). Theoretically, smaller listed firms should offer higher growth trajectories in comparison to larger listed firms on the JSE by virtue of being developing companies. However, the economic environment in South Africa for the past decade has been challenging with limited GDP growth. The combination of the difficult economic environment and lack of interest in small- and mid-cap firms has resulted in these firms often being undervalued. The growth of the small- and mid-cap sector plays a critical role in job creation, penetrating new markets and contributing to expanding existing markets in innovative ways. The success of small- and mid-cap firms is therefore important to stimulate the economy (Gavaza, 2021, Roberts, 2019, Lloyd, 2002). Small- and mid-cap firms face many obstacles. By gaining an understanding of the challenges they face, this research may aid the JSE in assisting these companies overcome these challenges. In addition, this research highlights this important area for the academic community to consider in future research.

An exploratory qualitative research method was employed because of the current gap in the literature. This research conducted semi-structured, open-ended interviews with senior financial executives (preparers) at small- and mid-cap JSE listed entities regarding the challenges they face preparing financial statements. In addition, limited interviews with auditors, regulators and academics were conducted to compare responses of the preparers and to ground the study. This grounding improved the validity of the study as a sense of triangulation is achieved while maintaining the exploratory focus of this study (Creswell, 2009, Alvesson, 2003).

1.1. Statement of the problem

Corporate financial reporting is complex, highly regulated and has been changing rapidly in recent years[1] (Chand et al., 2010). Companies with significant resources are in a good position to develop departments dedicated to staying up-to-date and preparing financial reporting (Naz et al., 2011). Small- and mid-cap companies are not necessarily able to do this. They tend to have less liquidity and limited published research available. This often causes small- and mid-cap firms to be undervalued and mispriced (Roberts, 2019). They are also likely to face different challenges to larger-cap companies and to prioritise the deployment of their limited resources differently. Small- and mid-cap firms hold the potential for high growth and the ability to evolve faster than the established large-cap firms listed on the JSE. It is important to identify the challenges that they face in producing high-quality financial statements as this may assist these firms in gaining investors. This could assist in their liquidity and in turn, their ultimate success.

1.2. Research question

This research addresses the following question:

> What challenges do small- and mid-cap JSE listed companies face when preparing financial reporting?

The research investigated what constitutes a 'high-quality' set of financial statements and whether this is something the company specifically sets out to achieve to address the research question. In other words, are the small- and mid-cap firms motivated to prepare high-quality financial statements as opposed to merely preparing a compliant set of financial statements?

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[1] Ten new standards have been published in the last 10 years and existing standards have been amended numerous times DELOITTE. 2021. *Effective dates of IFRSs and amendments* [Online]. Available: https://www.iasplus.com/en/standards/effective-dates/effective-ifrs [Accessed 08/03//2021 2021]..

1.3. Significance of the study

By understanding the motives and challenges small- and mid-cap firms face when producing high-quality financial reports, the JSE can adapt their listing requirements and regulations accordingly. At least, the JSE may now be in a better position to support these entities and implement initiatives to facilitate the development of these firms and, in doing so, the development of the country. These findings may also be useful to other developing countries in a similar fashion. This must be done with caution as challenges small- and mid-cap firms face in other developing countries may be different from those faced in South Africa.

1.4. Assumptions, limitations, and delimitations

- Assumptions: This research assumed respondents were open, honest, and complete in all responses.
- Limitations: The sample size was small and was not intended to form generalisations. Nevertheless, this is both typical of qualitative research and does not invalidate the study's purpose (Creswell, 2009, Alvesson, 2003, Rowley, 2012).The research appreciated that the COVID-19 pandemic may have impacted the interviewees' willingness and ability to spend time being interviewed. Therefore, there was a possible limitation that interviewees were only willing to be interviewed for less than the expected 60-90 minutes. Appropriate controls[2] were implemented when this occurred.
- Delimitations: For preparer interviews, only the most senior financial staff were interviewed. No middle or low-level financial staff were included. Their challenges may be different to those of the senior staff. However, the senior staff should have been aware of the significant issues that the lower levels are facing, thereby mitigating this delimitation.

1.5. Structure of the thesis

Section 2 covers the Literature review. Section 2.1. briefly discusses financial statement quality. This is to contextualise high-quality financial statements from those that merely attempt to be compliant. It also considers how the relevance of IFRS financial reporting may affect whether high-quality AFS are produced. Section 2.2. discusses the theoretical framework used to ground

[2] The intended number of interviewees were still interviewed, and each length was appropriate to cover the interview agenda thoroughly.

the research and facilitate the creation of a framework, illustrating the scenarios where financial reporting quality could differ in small- and mid-cap firms. The potential challenges small- and mid-cap firms may face in producing high quality AFS is discussed in Section 2.3. Finally, Section 2.4. summarises the challenges identified in the Literature review and how these will be used to guide the research further. The methodology is provided under Section 3. An overview of why a qualitative study was chosen is provided in Section 3.1. Section 3.2. and 3.3. explain how the data was collected via detailed interviews. The population and sample are discussed in Section 3.5., and Section 3.6. explains how the data will be analysed. Controls to ensure research quality and ethics were discussed in Section 3.7. and 3.8. respectively. The results are discussed in detail throughout Section 4. Lastly, a conclusion of the challenges facing small- and mid-cap firms in producing high-quality financial statements is provided in Section 5.

2. Literature review

2.1. Defining high-quality financial reporting as a baseline for the research

Reporting quality is a qualitative concept which has a series of diverse immeasurable attributes. In addition, users have their own (and different) expectations and perceptions of what constitutes a high-quality report (Cohen et al., 2004). A major limitation on the empirical studies performed on corporate reporting is the difficulty in obtaining consensus on what 'high-quality' is and measuring it objectively (Healy and Palepu, 2001). It is important to obtain an understanding of financial reporting quality and the efforts required to obtain high-quality financial statements for this research. Once there is an understanding of what is required to produce high-quality financial statements, it can be used as a baseline to compare the efforts of small- and mid-cap firms in the financial reporting process. .

The IASB states that a crucial prerequisite for quality financial reporting is the adherence to the objectives and qualitative characteristics of financial reporting (IASB, 2018). The characteristics are divided into (1) fundamental and (2) enhancing qualitative characteristics. Fundamental qualitative characteristics comprise relevance and faithful representation. If these are not present, the resulting information cannot be useful, regardless of the enhancing qualitative characteristics. Enhancing qualitative characteristics are comparability, verifiability, timeliness, and understandability. While these are important, and improve the usefulness of information, they, in themselves, will not result in useful information (Jonas and Blanchet, 2000).

Most researchers have fairly similar abstract notions of what constitutes a high-quality financial report but with slight differences in emphasis. Biddle et al. (2009), Tasios and Bekiaris (2012) and Cohen et al. (2004) focus on the precision and fair presentation of the firm's position and performance, but with particular attention to the presentation of cash flows, financial restatements and fraud. Elbannan (2011) focuses on the ability of the reports to communicate the underlying economics of the business. Tang et al. (2008) emphasise the need for the reports to be transparent before they can be considered high-quality reports.

2.1.1. Relevance of IFRS and its impact on financial reporting quality

Mandatory IFRS adoption decreases forecast errors, results in an increase in comparability and a higher quality of information and improves the overall information environment (Horton et al., 2013). The mandatory disclosures further increase the relevance of IFRS financial statements (Tsalavoutas and Dionysiou, 2014).

IFRS has evolved significantly since its creation in 2001. Research on the relevance of IFRS financial reporting is primarily focused on whether the initial introduction of IFRS in 2001 increased relevance. Minimal focus has been placed on the relevance after the introduction. Numerous new standards are the IASB's response to the financial crisis and various financial scandals in an attempt to increase transparency (Gea-Carrasco, 2015, Maxxia, 2019). The increased complexities of disclosures and standards may have decreased relevance of the financial statements by decreasing the understandability of the financial statements. A decrease in relevance may result in users and management utilising financial statements for decision making purposes. This may affect the necessity and motivation behind producing high-quality AFS.

2.2. Theoretical framework used to ground the research

The purpose of this section is to ground this thesis in the prior academic literature. Section 2.2.1. discusses the stakeholder theory and explains how a closer relationship between management and a firm's investors could lead to less emphasis being placed on producing high-quality financial statements. Section 2.2.2. considers the agency theory and the contrasting effects it could have on the management's motivation to focus on high-quality financial reporting. It also discusses an instance where agency costs could decrease for small- and mid-cap firms. The reputation effect is explored in Section 2.2.3. discussing the relationship between a firm's reputation and the quality of financial statements produced. Section 2.2.4. considers the resource dependency theory. It focuses on the dependency of the firm on its investors, and the power these investors have over the firm. It then considers how this affects the firm's necessity to produce high-quality financial statements in Table 1. Finally, Section 2.2.4 facilitates links drawn between the 4 theoretical frameworks to develop a framework of why differences could be expected to be seen in the quality of financial reporting of small- and mid-cap firms.

2.2.1. Stakeholder theory

Stakeholder theory, as opposed to the shareholder theory, looks more broadly at which constituencies it should be accountable to (Phillips et al., 2003). When this theory is applied to the production of financial statements, the firm needs to produce quality financials to satisfy the wider group of stakeholders and not only shareholders. This should provide decision-useful information and afford stakeholders the information required to judge and hold management accountable for their stewardship of company resources. The fewer stakeholders a firm has that are interested in financial statements, the less emphasis management will place on producing high-quality financial reports, and vice versa. The closeness of the relationship which exists between management and the stakeholders would also be expected to affect the quality of the reports produced. The closer the stakeholders are to management and the more they trust them, the less emphasis will be placed on producing high-quality financial statements.

2.2.2. Agency theory

Agency theory details the relationship between a principal and an agent. In this research's context, the agent is management, and the principals are the shareholders. The theory explains and resolves issues between these parties. Firms are required to produce financial reports to provide assurance to their shareholders about where their funds are being allocated and how they are being utilised.

The investments made into small- and mid-cap firms are less than those being made into larger-cap firms on the JSE because they are inherently worth less (Rizqia and Sumiati, 2013). The investors may not have as much diligence in going through the companies' financial reports in as much detail because their investments not being as material and significant in size. This links to the agency theory. Since principals are likely to consider less, there is a smaller risk of lower-quality reports being identified by users. This may lead preparers feeling that it would be a waste of time and resources to create high-quality reports. Although investors may use other means to hold management accountable through management accounts and other performance metrics. If this were the case, agency costs would decrease, as the time to analyse management accounts will be less, and fewer resources will need to be allocated to ensuring financial statements of a high-quality are produced.

Paradoxically, smaller companies have a greater incentive to produce high-quality financial reports as these reports can be used as a mean to enhance their credibility and differentiate themselves from others when competing for funding. Improved information quality, combined with enhanced controls may result in investors having greater confidence in the quality of the financial reporting, increasing their chance of providing capital to these firms (Bédard and Gendron, 2010).

2.2.3. The reputation effect

Cao et al. (2012) researched the correlation between a firm's reputation and the quality of the financial reports they produced. The 'reputation effect' is the idea that players' actions are affected by reputation (Weigelt and Camerer, 1988). The reputation of a firm affects stakeholders' perceptions about the company and it links these perceptions to firm valuation (Filbeck and Preece, 2003, Anderson and Smith, 2006). There is a relationship between the reputation of the firm and the activities and costs of debt and equity financing (Diamond, 1991, Siegel, 2005). Diamond (1991) and Siegel (2005) found that the reputation effect can be viewed as a complement to corporate governance mechanisms in decreasing agency problems. This motivates firms to maintain high-quality reporting, leading to a negative association between firm reputation and the likelihood of misstatements and a positive association with reputation and audit fees (Cao et al., 2012).

2.2.4. Resource dependency theory

Resource dependency theory describes an organisation's relationship between power and resource-dependence. This theory proposes that there is an inverse relationship between A's power over B and A's dependence on resources provided by B. The dependence on B is also a function of the availability of the resources B provides to A. The more widely available the resource, the less dependence A has on B, and the higher A's power over B (Freeman et al., 2010). This can be roughly related to demand-supply theories in economics.

Based on the resource dependency theory, Table 1 explains the 6 cases which were expected to be found in the research. In summary, as the firm's dependence on investors for resources increases, the higher the power the investors have over the firm. The greater power the investors hold over the firm, the more the firm must adhere to the needs of the investors. In this instance, if the investors require high-quality financial statements to satisfy their information needs, a greater necessity will exist for the firm to allocate its resources towards producing high-quality financial statements. Similarly, the opposite would hold true.

Typically, an organisation's motivation to manage external dependencies does not necessarily coincide with what it realistically can do to absorb its constraints (Casciaro and Piskorski, 2005). Small- and mid-cap firms are expected to have fewer financial resources than larger firms, making it probable that, despite their motivation to manage their external dependencies, they may not financially be able to. With the limited financial resources small- and mid-cap firms have, they would more likely allocate them to areas probable of realising seen returns. The extent of power which debt and equity investors have over a small- and mid-cap firms depends on the firms' dependence on the debt/equity investor. The more power debt/equity stakeholders have over an entity, the more likely the entity is to spend limited resources of ensuring high-quality financial statements, irrespective of whether it is a profit earning activity or not.

Table 1: The various cases that may be found in small- and mid-cap firms listed on the JSE.

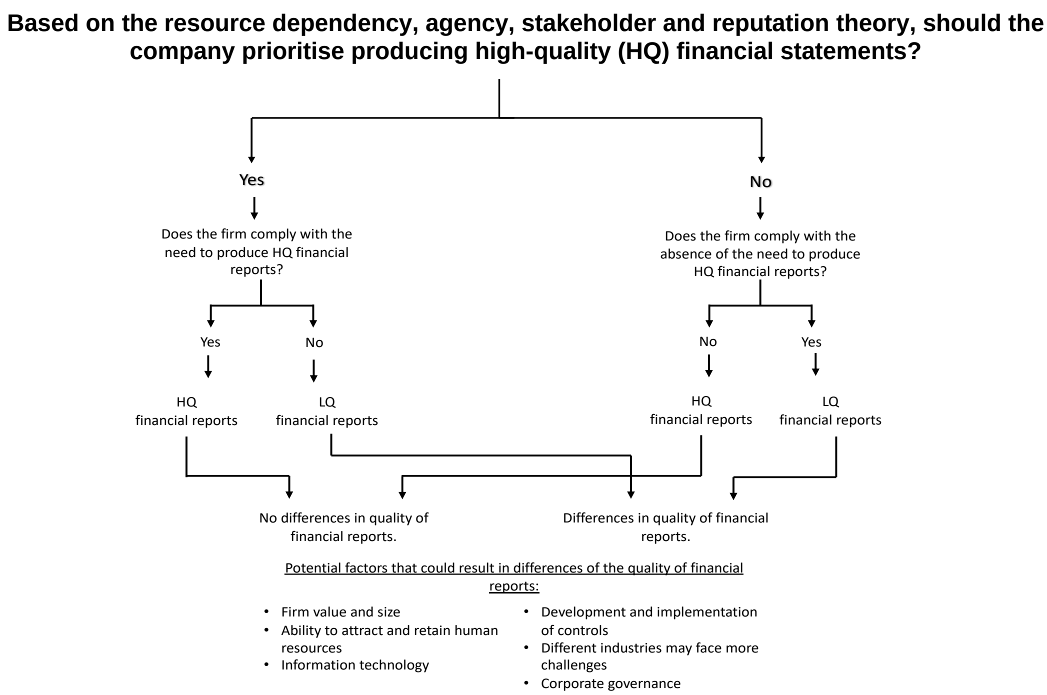
Case	Application of resource-dependency theory to case
Case 1: High dependence on many independent equity investors.	Investors have high power over the entity and since there are many independent investors, the firm cannot make face-to-face or other representations with these stakeholders to make up for lower-quality financial reports. The firm will spend its resources to ensure that it prepares adequate financial reports to satisfy the stakeholder's needs, despite the act of preparing financial reports not providing a financial return.
Case 2: High dependence on a few independent equity investors	The few investors the firm has would have high power over the firm. However, the relationship between the firm and the investors would possibly be closer. This could result in the firm allocating less resources towards producing high-quality financial reports since the few investors may be satisfied with detailed management accounts. In addition, there may be more inherent trust if there is a close relationship between management and the few equity holders. At the same time, the information gap between the principal and agent may be less resulting in a lower need to produce high-quality reports.

Case 3: Low dependence on independent equity investors	The firm does not depend on independent equity investors; thus, they do not have power over them. The firm has a low incentive /pressure to spend resources on producing high-quality financial reports.
Case 4: High dependence on a few external debt financiers	Creditors have power over the firm. They would likely request detailed information and the firm could provide this on a month-to-month basis to them, through management accounts, because there is so few of them. Creditors would not be highly concerned over the quality and detail of the financial reports, as long as they are audited to provide assurance that the month-to-month accounts they have been receiving are correct. The firm would not focus a large number of resources to developing high-quality financial reports.
Case 5: High dependence on many external debt financiers	Creditors, as in Case 4, have power over the firm. However, in this instance, it is not feasible for the firm to provide management accounts monthly to a large number of external financiers. The firm would focus resources on producing high-quality financial reports to compensate external financiers for this.
Case 6: Low dependence on any external financing (likely the least common example)	Similarly, in Case 3, the firm does not depend on external financing, making it self-sufficient. Debt investors have little power over the firm. The firm has a low incentive / pressure to spend resourced on producing high-quality financial reports. It may, instead, allocate its limited resources on ensuring profitability to maintain its lack of dependence on external financiers.

2.2.5. Differences in the financial reporting quality based on the theoretical framework

In Figure 1 below, the diagram illustrates a possible sequence of events that would determine whether they would produce high-quality financial reports or not. If firms should prioritise producing high-quality financial reports (based on the cases above), they can comply with this need and produce high-quality financial reports or choose to ignore this need and produce low-quality reports. Similarly, if firms do not have to prioritise producing high-quality financial reports per the resource dependency theory, they again have one of 2 choices: (1) to comply with no need to produce high-quality financial reports and produce low-quality financial reports; or (2) ignore the need to produce high-quality financial reports and produce high-quality financial reports. This will result in firms producing high-quality financial reports having little, if any differences in their financial reporting quality, whereas those not prioritising high-quality financial reporting having differences in the quality of financial reporting.

Figure 1: Framework illustrating whether differences will be expected to be found in the quality of financial reports



Small- and mid-cap firms are likely to have a high dependence on their investors as they are expected to have limited resources due to their small size. They are also likely to have fewer investors due to their shares often being seen as less attractive and riskier. As such, Cases 2 and 4 are the most likely to be found in the research. In both these instances, dependence on few investors results in a closer relationship. In line with the stakeholder theory, the closer the relationship, the more trust will exist between the 2 parties. In addition, as this trust grows, the information gap between the principal and the agent will decrease. Due to the fewer number of investors, simpler resources may be used to satisfy their information needs. As explained under the agency theory, agency costs would decrease, and less resources will need to be allocated to ensuring financial statements of a high-quality are produced. As the firm’s reputation is dependent on these investors, but not obtained using financial statements, the motivation and need to yield high-quality financial statements would decrease further. Small- and mid-cap firms would be expected to not have a need to produce high-quality financial statements. If they adhered to the absence of this need, lower-quality financial statements would be produced and differences in the quality of financial statements would be found.

2.3. Potential challenges impacting the quality of financial reporting

This section focuses on the challenges that small- and mid-cap firms could be experiencing in producing high-quality financial statements. These challenges could exist due to small- and mid-cap firms adhering to the absence of the need to produce high-quality AFS, as explained in the prior section. They may also exist if small- and mid-cap firms do have the need to produce high-quality AFS or having the motivation to yield high-quality AFS despite the absence of the need, but do not have the financial resources to do so.

Section 2.3.1. discusses the relationship between firm size and value and degree of accountability a firm has to the society it operates within. Section 2.3.2. considers the various challenges that could affect small- and mid-cap firms' ability to attract and retain talented finance staff and the impact this could have on the financial reporting process. The influence that I.T. systems and the development and implementation of controls have on the quality of financial reporting is considered in Section 2.3.3. and Section 2.3.4. respectively. Different industries are likely to have varying levels of complexity due to differences in accounting policies used. The effect of this is discussed in 2.3.5. Section 2.3.6. discusses the impact of the level of organisational structure in a firm has on producing financial statements. The various corporate governance structures and their role in the financial reporting process is considered in Section 2.3.7., including the external audit, IAF and audit committee. Finally, Section 2.4. draws a conclusion on the possible challenges small- and mid-cap firms may face in producing high-quality financial statements and how this will guide research further.

2.3.1. The effect of firm value and size on the ability and necessity of producing high-quality financial statements

There is a positive association between the quality of integrated reports and firm value and size (Lee and Yeo, 2016). Larger entities have greater access to resources to allocate to collecting and analysing information used to produce integrated reports, resulting in higher quality reports (Buitendag et al., 2017). Linking this to the resource dependency theory suggests that small- and mid-cap firms may produce lower quality financial reports, compared to larger firms, because of limited resources.

Larger entities tend to have a significant impact on society, resulting in them receiving more attention from the general public and more pressure (power) being exerted by various stakeholder groups (Buitendag et al., 2017). Each stakeholder provides the firm with a resource either financing, patronage, or acceptance. On one hand, larger firms must place more emphasis on producing high-quality financial reports per Case 1 theory - high dependency on many independent equity investors. Larger firms are likely to do this easily since they may not have to use their resources sparingly. On the other hand, the extent to which they must produce high-quality financial reports depends on how dependent they are on the stakeholders to provide them with their resource. With regards to the stakeholder theory, this indicates that smaller firms may not have as much pressure to produce adequate financial reports, resulting in management allocating time and resources elsewhere. Paradoxically, smaller firms have greater potential to grow and depend more on their stakeholders for the resources to provide them with such growth, providing their stakeholders with more power over them (see 2.2.2. - resource dependency theory). Firms with greater growth opportunities have a tendency to disclose more than what those with lower growth opportunities do (Murcia and Santos, 2012). To obtain the funding and obtain their resources required for growth, they adopt better corporate governance mechanisms to be more transparent for stronger investor support (Buitendag et al., 2017).

2.3.2. Ability to attract and retain quality human resources

To assist in achieving high-quality financial reporting, Rezaee (2003) developed a 6-legged stool model. The 6-legs are (1) commitment from the board of directors, (2) audit committee, (3) top management team, (4) internal auditors, (5) external auditors and (6) the governing bodies. With the limited resources small- and mid-cap firms have, it is probable that 6-legs to the financial reporting process are not as effective, resulting in lower quality financial reports. However, if they must produce high-quality financial reports, in line with the resource dependency theory, there may be little difference in these 6-legs between firms, whereas, if they do not need to produce high-quality, or choose not to, there may be differences in these 6-legs.

In North America, it has been found that small- and mid-cap firms struggle to compete against their larger counterparts both in attracting and retaining their employees because from a financial perspective they cannot offer the same level of compensation (Appelbaum and Shapiro, 1991). Small- and mid-cap firms in South Africa are likely to experience the same frustrations. Within the public sector, firms also struggle to attract and retain talented human resources. There is a lack of willingness in workers to accept lower pay in exchange for working in the public sector for a more 'meaningful' job, and because of this lower pay, the result is a lower per unit output price in the public sector compared to the private sector (Delfgaauw and Dur, 2010). In turn, a public-private earnings penalty is created for managers and this increases in managerial ability. Consequently, the relative attractiveness of the public sector decreases with an employee's ability. This creates lower competition in the sector and less diligent people are not removed as quickly as in the private sector where competition is fierce. The total focus on profit maximization results in ineffective managers being ousted more readily in private firms. Hence, the 'best and brightest' managers typically reside in the private sector with the less talented and dedicated managers remaining in the public sector (Delfgaauw and Dur, 2010). If the same is found to be true within small- and mid-cap firms, they may lack the competitive edge to attract the best talent available.

This is consistent with a study which focused on banks. It found that larger banks were more likely to have management teams comprised of younger and tenured managers with more educated and diverse backgrounds. There is a positive relationship between firm size and innovation. However, this relationship is partially due to the management teams that are making the decisions, and the firm size contributes to the team that is obtained. Larger banks are required to have talented management who are up to date with technical training because of the regulatory pressure exerted onto them. Smaller banks are insulated from these pressures and are less responsive to them. Smaller banks have little pressure to change, and thus do not have the same need to have talented management. They will continue with placing tried-and-true employees in management positions. Larger banks have pressure to break from the status quo. They tend to recruit younger and more educated management, in the belief that these are more likely to succeed in pursuing innovative strategies to the shifting environment. This suggests that smaller banks prefer not bringing in new talent nor better talent. However, small banks are also less equipped to compete for younger, more educated, and innovative managers. Larger banks have a competitive edge over smaller banks for numerous reasons, such as their ability to pay, promotion opportunities, prestige image and that managers' knowledge will be more fruitfully used at a larger firm. This is indicating that the size of the firm determines the composition of the management team they obtain. The inverse can also be true. The team composition may cause the size of the firm – as effective organisations grow faster than ineffective ones. Consequently, size and team composition are potentially correlated because team composition results in innovation. In turn, this facilitates growth. Thus, larger firms are can attract the best quality management, and at the same time consistently further their growth (Bantel and Jackson, 1989).

Similarly, in the small banks, the same can apply with regards to industries across the small- and mid-cap sector. Small- and mid-cap firms may have less pressure exerted on them by their stakeholders since the size of the investments made in them are inherently worth less than in large-capped firms (Rizqia and Sumiati, 2013). Smaller listed companies would then be insulated to the pressures of preparing high-quality financial reports and regulatory requirements. They will be less equipped to compete for the best talent, however, they would have no need to pursue younger and more educated management. This would result in their finance teams comprised of employees who are older and with lower financial expertise.

The more educated the members of the finance team are, the more innovative they will be. This increased level and diversity of expertise is beneficial for complex problem solving. The heterogeneity within the finance team positively creates innovation and creative decision making (Bantel and Jackson, 1989). With less experience and diversity within the finance team, small- and mid-cap firms would have lower innovation, and a decreased ability for complex problem solving which in turn will affect the quality of the financial statements produced.

If small- and mid-cap firms experience similar struggles to the public sector, they further struggle in the retention of their accountants, resulting in a high staff turnover rate (Delfgaauw and Dur, 2010). The lack of high-level expertise in financial reporting and consistency in who is preparing these financial reports can result in a greater challenge to generate and maintain high-quality reports. Contrary, they may rather have a lower staff turnover – large-cap firms tend to have teams with heterogeneity due to the diversity they seek for innovation, but they become subjected to higher turnovers, due to increased conflict and decreased communication creates a stressful work environment (Bantel and Jackson, 1989). Since small-and mid-cap firms may tend to have homogeneity from less diverse financial teams, this can create a lower turnover.

Non-financial benefits also contribute to attracting and maintaining human resources. Although, in Third World countries, financial rewards provide a greater incentive due to high inflation and difficulty in retaining social status. Nevertheless, the importance of non-financial benefits cannot be ignored, although may play a less significant determinant in South Africa (Yousaf et al., 2014).

Maslow (1958) developed the hierarchy of needs theory, which has been used to determine what motivates employees and keeps them satisfied. The hierarchy classified human needs into 5 levels: (1) basic psychological needs, (2) safety and security, (3) belongingness/social acceptance, (4) esteem and (5) self-actualisation. This theory explains why some workers care more about job security, remuneration or close relationships with co-workers. Others prefer opportunities for achievement, challenging tasks and success (White, 2005, Wong and Chung, 2003). It is expected that the first example of workers will be found in the small- and mid-cap sector, since prestige is not present and non-financial benefits are valued over achievement and success. The second example of workers will reside in the large-cap sector due to their competitiveness and self-value.

Individuals have an inherent need to believe that their work is meaningful. Maslow (1958) argued that those individuals who do not consider their work to be meaningful are less likely to work to their professional capacity. If less talented employees are found within the small- and mid-cap sector, that do not see the worth in the work that they perform, this may lead them to preparing lower quality financial statements.

Although small- and mid-cap firms may provide attractive non-monetary benefits which can aid them in the competition for talented human resources (Appelbaum and Shapiro, 1991). Unfortunately, smaller businesses lack the skill at managerial level to implement these techniques successfully. If they obtain the skills to market and implement non-financial remuneration incentives, it will give them leverage against the 'corporate machine'. Job enrichment involving flexibility in work content and hours, participation, recognition and strong, trusting relationships amongst work colleagues are examples of non-financial benefits (Appelbaum and Kamal, 2000).

2.3.3. Impact of Information Technology (I.T.) Systems on the quality of financial reporting

I.T. systems influence how AIS operates in preparing, presenting and delivering accounting information and provides a significant contribution to the accuracy, timeliness and overall quality of information produced (Mamić Sačer and Oluić, 2013). With larger firms likely having more resources, they can afford sophisticated I.T. software and systems. Sophisticated software gives firms flexibility. As the needs of the firm change, these systems provide the ability to extract desired information at a granular level. This assists in decision-making and making adjustments to reporting due to changes in regulatory requirements swifter and easier. These systems may further affect their chart of accounts. Sophisticated I.T. systems will provide a more detailed, precise level of capturing groups at various levels which is likely to translate to the quality of the financial reports produced from this information.

2.3.4. Development and implementation of controls at small- and mid-cap firms

Doyle et al. (2007) found that firms which are smaller, less profitable, more complex, growing rapidly or undergoing restructuring are more likely to have material weaknesses in their internal controls systems. It is expected that smaller firms may be unable to implement sophisticated internal controls, combined with a limited ability to implement segregation of duties, which is in turn likely to have an effect of the quality of financial reports produced.

2.3.5. Industry specific challenges towards financial reporting quality

The quality of an integrated report is affected by the type of industry belongs to (Buitendag et al., 2017). The accounting policies applicable to each company and the challenges they bring will differ across industries on the JSE. Some industries are involved in transactions/events that are inherently more complex and have similarly complex accounting standards. For example, the financial industry will have to apply IFRS 9. Firstly, it is a new standard which inherently makes it likely to be more challenging initially. Secondly, the introduction of IFRS 9 may result in negative consequences because of the degree of subjectivity and modelling complexity involved in applying it (Hronsky, 2010). This makes the financials industry inherently more complex accounting in comparison to industries such as consumer goods. It is expected that some industries will have a higher cost of financial reporting, increasing their challenge to produce high-quality financial reports.

2.3.6. Organisational structure and its influence on the financial reporting process

Organisational structure has been interpreted in numerous ways. Mintzberg (2007) has stated it is how jobs within the firm are divided and coordinated. Greenberg (2014) and Damanpour (1991) propose that it includes formal configuration among individuals and groups and includes a hierarchy, level of horizontal integration, centralization of authority and patterns of communication.

An organisational hierarchy exists within firms. Organisational structure has a purpose of providing division of work amongst members of the firm and coordinating their activities so that they are all directed to the same goals and objectives of the organisation. Top management are positioned at the top of the hierarchy while employees are positioned at the bottom. Employees who are directly involved in day-to-day activities generally have direct access to local information and the changes in this information which occur daily. For top management to make decisions and report to the entity, they require information which needs to be processed upward from the bottom of the hierarchy. This results in numerous information-processing costs such as, costs of communication, costs of miscommunication and opportunity costs from delays in communication (Gurbaxani and Whang, 1991). Preparing reports without accurate, timely and valid information will have a direct effect on the quality of the financial reports produced (IASB, 2018). The sum of these costs and the agency problem that comes with it, increases as the person who prepares the financial reports moves higher up the hierarchy and as the level of organisation within the firm decreases.

2.3.7. Corporate governance and its role in financial reporting quality

Corporate governance is a phrase, which until recently, meant minimal to most shareholders and stakeholders. As scandals have been on the rise, it has become a staple of discussion in companies. It can be defined as the behaviour of corporations, in terms of their performance, efficiency, growth, financial structure and treatment of shareholders and other stakeholders (Fooladi and Nikzad Chaleshtori, 2011). One of the functions of corporate governance is to ensure that financial reports are of a high-quality. An association has been found between companies yielding poor financial reporting quality, earnings manipulation, financial statement fraud and weak internal controls with poor corporate governance (Dechow et al., 1996, Beasley, 1996, McMullen, 1996, Beasley et al., 1999, Beasley et al., 2000, Carcello and Neal, 2000, Klein, 2002)– as seen in Figure 3 under Appendix 1. Figure 2 depicts the corporate governance mosaic produced by Cohen et al. (2004). It illustrates the interrelationships of various roles and mechanisms within corporate governance and the influence each role has on financial reporting quality. They suggest that the drivers to a high-quality financial report are external auditors, internal auditors, the board of directors (management) and the audit committee. Additionally, these factors can be affected by the firm's ability to attract and retain quality human resources, the firm's financial resources and the IT that they must process their data and prepare the reports. It is associated with lower cost of capital, high returns on equity, greater efficiency, and more favourable treatment of all shareholders. Of recent, it has gained importance for both economic development and well-being (Becht et al., 2003). These components of corporate governance are likely to play a pivotal role in the ultimate success of small- and mid-cap firms.

Impact of external assurance on financial reporting quality

External assurance has been shown to have an influence on the quality of financial reports. It provides organisations with the ability to indicate to their key stakeholders that their reports are credible (Simnett et al., 2009, Kolk and Perego, 2010). Over and above providing credibility, assurance can test the systems and processes underlying the preparation of reports and following the results with recommendation. Through this, auditors provide advice to clients in improving their systems and providing clients with technical accounting advice. The audit of financial reports by an independent party can enhance the quality of the report produced (Dopuch and Simunic, 1982, Watts and Zimmerman, 1986).

The strength of the board affects the quality of the external auditor. Stronger boards are more likely to demand a higher quality audit and interrogate their findings to ensure that they discharge their responsibilities in terms of the Companies Act to direct and monitor the company (Companies Act, 2008). Small- and mid-cap firms may have weaker boards than large-cap companies if they struggle to attract talented human capital. If this occurs, their boards may demand lower quality external audits.

There is a variety of accredited auditors on the JSE other than the Big 4 auditors (Steenkamp, 2011). There may be variability of their external auditor for small- and mid-cap listed firms. Audits performed by larger (Big 4) audit firms are associated with higher quality audits (Ettredge et al., 2011). Large audit firms have more resources such as better research facilities and greater technological capacities (Dezoort et al., 2000). Big 4 auditors have greater in-house experience. They are more likely to issue going-concern audit reports. This may be indicative of them being able to take a more aggressive stance in providing their audit opinions, since they may not be as dependent on a single audit client as smaller audit firms might be (Francis and Yu, 2009). This also enables them to perform as professionally as possible (Sawan and Alsaqqa, 2013). Big 4 firms are less dependent on clients individually, since their client base is large. The materiality of each client for smaller audit firms is higher since their client base is smaller. Smaller audit firms may conclude that they have more to gain by misreporting than from potentially losing a client (DeAngelo, 1981). A Big 4 has a greater reputation to lose if they misreport. Once they obtain their reputation, they have an incentive to maintain it by consistently delivering high-quality audits (DeAngelo, 1981, Francis and Wilson, 1988, Simunic and Stein, 1987). Consequently, the degree of compliance and audit quality is directly positively correlated to audit firm size (Sawan and Alsaqqa, 2013). However, audit quality has not found to be unacceptably low at non-Big 4 audit firms (Francis and Yu, 2009). It also does not necessitate that Big 4 firms are constantly superior. Rather, on average, they have found to provide higher quality audits than smaller audit firms (Francis, 2004).

Big 4 firms also have more industry specific expertise. Industry experts have a greater knowledge than non-experts as they have more experience within the industry, and this enables them to make more accurate audit judgements (Solomon et al., 1999). Larger audit firms have more clients, and this provides them with more opportunities for their auditors to acquire more knowledge in various industries. This is a contributor to higher audit fees charged by the Big 4 (Francis, 2004). The relevance of the audit fee is emphasised when the client-auditor relationship begins to decline (Fontaine et al., 2013). If there tends to be a poor client-auditor relationship experienced by small- and mid-cap firms, this may motivate them to reduce audit fees by choosing a smaller audit firm over a Big 4 firm. If a firm is audited by a smaller audit firm, there is a risk that these auditors would not be specialised to the particular industry of their client, or have as much experience in this industry in comparison to one of the Big 4. This would possibly impact these smaller auditors from having an in-depth understanding of their clients issues assisting the client in them, leading to smaller firms obtaining lower quality audits from audit firms that are less experienced than the Big 4.

In contrast to this, Behn et al. (2008) thought that audit firm size should not affect the quality of the external audit, since professional standards and qualifications are maintained throughout the sector. Overall, the collective literature is still strongly supportive audits performed by the Big 4 are of a higher quality.

Arruñada (2013) explains that audit firms provide increasing audit quality as client size increases in response to varying demands of quality amongst clients. As explained previously, a principle-agent relationship exists among investors and management. Management of the firm is the agents and investors are the principals who wish to monitor the agent and do so through the external audit. Firms have different financial and contractual structures and through these have a varying degree of conflict. As agency costs increase, the demand for higher-quality audits increases. If there is low dependence on financiers (Case 6) or if investors do not place much pressure on management for proof on how they have managed their resources since their investments are worth less, agency costs would be minimal. This will lead management of small- and mid-cap companies to be less concerned over the quality of the external audit received.

Supervision of the audit has been found to increase as the firm size increases (Xing, 2012). Small- and mid-cap firms are then expected to have lower supervision on their audits, in comparison to large-cap firms. Lower levels of supervision on small- and mid-cap listed firms may further negatively affect the quality of audits they receive.

Johnson et al. (2002) studied the relationship between audit tenure and financial reporting quality. On one side, as audit tenure increases, there is a learning curve which develops with respect to client-specific knowledge and incentives to stress retaining clients may also develop. Similarly, incentives of the auditor can shift because of a sense of complacency with the client and an increased confidence in the client. These factors can gradually decrease the auditor's contribution to the quality of financial reports produced. They found that this caused a decline in quality of the reports, however, it was not significant (Johnson et al., 2002).

An audit service can be defined into 2 separate components: core value and value-added (Grönroos, 1997). The core value is defined as the primary billable service (providing an independent audit opinion on the financial statements). The value-add is provided when audit services incorporate adding value to the core audit service. It results in an audit which includes additional formal and informal business advice, provides personal attention and support, and exceeds what is usually provided in a standard audit service (Herda and Lavelle, 2013, Fontaine et al., 2013, Eilifsen et al., 2001). Clients in prior research have indicated 3 themes which they see as additional support from their external auditors: (1) auditor-client relationship quality, (2) additional advice on accounting and general business issues and (3) validation on the work performed in relation to IFRS complexities and implementation. Availability has also been suggested as an element of a value-added audit service. It is the ability to contact the external auditor freely and for the auditor to provide their time to understand the client's business. There is a fine line in providing value-add to the client while still remaining independent (Fontaine et al., 2013). Higher-quality relationships among auditors and clients lead to higher levels of service that go beyond the minimum requirements of the audit itself (Herda and Lavelle, 2013). It is questionable whether external auditors spend as much time, effort, and resources to provide these value-adding services to smaller clients, like small- to mid-cap firms. If audited by a Big 4 firm, less value add may be provided to smaller clients, since the Big 4 may prefer to provide it to their bigger clients. There is a possibility of audits on smaller clients becoming 'box-audits' and having the newest or least experienced partners and managers assigned to them. This could lead to little help for improvement being identified and provided, leading to these audits providing minimal value to the improvement of the financial statements produced by small- and mid-cap firms.

Sophistication of the audit committee and its effect on the financial reporting process

Audit committees are under increased scrutiny because of the frequent scandals of late. This has increased the level of regulatory responsibilities that are assumed by audit committees and the expectations that stakeholders have regarding the capabilities of the audit committees. Their increased responsibility has caused them to have a greater influence on the quality of financial reporting that is produced, giving them the ability to improve the quality of information, as seen in Appendix 2 (Bédard and Gendron, 2010).

Two factors were identified by Krishnamoorthy et al. (2002) that affect the ability of the audit committee in ensuring high-quality reporting: (1) lack of sufficient financial sophistication and (2) lack of power or will of the audit committee to work towards ensuring sound financial reporting. Ettredge et al. (2011) and Bédard and Gendron (2010) found that the competency, independence, financial literacy and expertise, governance expertise and knowledge of the company have an influence on the effectiveness of the audit committee and are positively correlated to the financial reporting quality and high-quality reporting disclosures (Al-Shaer et al., 2017). Further, the level of financial expertise is positively correlated with the audit committee's ability to detect and appropriately report fraud (Felo et al., 2003, Farber, 2005).

The resources available to audit committees of small- and mid-cap firms may be limited. Remuneration may then impact small- and mid-cap entities' ability to attract and retain talented audit committee members, leading to them having a lack of sufficient financial sophistication. There is a positive association between the number of financial experts on the audit committee and IFRS compliance (Ettredge et al., 2011). The audit committee member's remuneration may not be sufficient to warrant them spending greater effort on adequately fulfilling their responsibilities, leading small- and mid-cap firm's audit committees having a greater chance of having the will to work towards high-quality financial reporting. The possible decrease in audit committee quality of small- and mid-cap firms may affect the quality of the financial reports they can produce. However, Rainsbury et al. (2009) found no association to exist between the quality of the audit committee and the quality of financial reporting produced.

As the engagement between audit committee members increases, by meeting 3 or more times a year, the quality of reported earnings improves significantly (Ghafran, 2013). If audit committee members are less motivated to perform their duties, this can result in a lack of engagement which would affect the quality of reporting.

As financial expertise increases, there is a positive impact on the external audit fees, and as additional directorships increases, there is a significant negative impact on external audit fees (Ghafran, 2013). Since small- and mid-cap firms may have audit committees with less financial expertise, this would result in a negative impact on audit fees and can increase the likelihood of their receiving audits from non-Big 4 audit firms.

As the number of directorships a member holds increases, the member becomes overstretched. Their commitment decreases and so does their ability to effectively oversee a firm's financial reporting process. A negative association exists between the number of directorships members of the audit committee hold and the quality of financial reporting (Ghafran, 2013). It is expected that small- and mid-cap firms would have audit committee members with less experience and diversity, resulting in members with few directorships. This may enhance the audit committee function since they would have sufficient time to allocate towards the firm. Although, Tanyi and Smith (2015) found this to be applicable only to the chair of the audit committee and not to the members of the committee.

Sophistication of the internal audit function: In-housed versus outsourced?

The internal audit function (IAF) is an effective means to monitor the financial reporting process. The internal audit function (IAF) can affect the quality of financial reporting through the following: (1) the audit of financial statements, (2) compliance auditing and (3) special consulting projects. Within audits, the IAF can influence the financial closing process, reviewing procedures for nonstandard journal entries and post-closing adjustments. Through compliance auditing, they have influence on testing journals or transactions for compliance with the company's financial reporting policy. The IAF is involved in special consulting projects through assistance in accounting matters that require further attention (Abbott et al., 2016). A close relationship between internal auditors and the audit committee has the potential to enhance corporate governance capabilities of both parties (Cohen et al., 2004). When the internal auditors report directly to the audit committee instead of the board (management) and they become an agent of the audit committee, their independence and perceived value increases. As the oversight of the audit committee increases over the IAF, the independence of the IAF is enhanced greatly. The effectiveness of the audit committee is also increased as it has the capability of deploying resources on the internal audit function to find important information on problems occurring in the company. This allows accounting policies and internal controls to be strengthened and for added assurance on the quality of financial and non-financial measures used to produce high-quality financial reports (Cohen et al., 2004).

Both competence and independence are necessary for an effective IAF financial reporting monitoring. Individually, they are not sufficient alone to constitute a quality IAF. A competent auditor is more likely to detect issues within the firm, and financial reporting misstatements, the reporting of such is dependent on the auditor's independence. Thus, competence and independence are distinct constructs (DeAngelo, 1981, Abbott et al., 2016). Internal auditor independence is a direct function of the reporting relationship between the audit committee and the IAF. Reporting to the audit committee must be combined with active oversight by the audit committee on the IAF, and not management. Prior literature has shown a positive association between greater audit committee oversight and greater independence of the audit committee – since this provides a shield from management pressure (Quarles, 1994). When the IAF is not removed from management pressure, those in management positions can reduce the likelihood that issues are reported to the appropriate channel. As independence increases, the likelihood that financial reporting policy departures are either properly reported to the audit committee/external auditors or corrected by the party responsible, increases. This leads to greater financial reporting quality (Abbott et al., 2016).

An outsourced internal audit function which reports to the audit committee is more likely to deter as well as report fraud. When the internal and external auditors work together as partners, it increases the ability for the highest quality financial reports being provided to all stakeholders. Outsourced internal audits provide management with flexibility. Management can adjust IAF costs during the year since the outsourced hours are variable. They are further able to defer expense recognition into the following periods by scheduling the outsourced IAF into the following year.

This flexibility is particularly attractive to management when the firm experiences revenue shortfalls (Abbott et al., 2016).

By having an in-house internal function, there is a significantly higher chance that the board is more likely to report but not deter fraudulent reporting (Cohen et al., 2004). In-housed IAF are fixed due to permanent employees having salary structures. In-housed internal audits have less independence. Internal auditors may have less willingness to confront management on issues because of the fear of job-loss (Abbott et al., 2007, Quarles, 1994). Despite having an IAF that is competent, if they lack independence, they will be less likely to report. Similarly, if they possess independence, but lack competence, they will be less likely to detect the issue.

2.4. Identified challenges and focus areas for further research

Financial reporting quality forms the foundation of the research. It is important to determine the interviewee's perception of financial reporting quality as this is likely to have a direct influence on how the interviewee perceives the quality produced by their company (in the case of preparers) and of other entity's. This will also provide an understanding of the activities required to achieve high-quality financial statements and measure management's efforts in the financial reporting process against this. Research will be focused on obtaining an understanding of the interviewee's perception of financial reporting by questioning their opinion on IFRS financial reporting and the qualities that distinguish high-quality financial statements from low-quality.

As per Table 1, Case 2 and 4 are the most likely cases to appear in the research. Financial resources may be limited resulting in high dependence on few investors, either equity or credit, as their shares are unlikely to be widely dispersed. Per the stakeholder theory, this could lead to closer relationships developing between management and the investors. Simpler resources are likely to be used to satisfy the investors information needs. As explained earlier per the agency theory agency costs would decrease. Due to the resource dependency theory and the reputation effect, management may be less motivated to deliver high-quality financial statements. If they adhere to the absence of the need to produce high-quality financial statements, less resources will be allocated to the areas that influence the quality of financial reporting (Figure 1). Even if they are still motivated to prepare high-quality AFS, small- and mid-cap firms may be unable to do so due to financial constraints. It is important to determine during the research which case is applicable to the company of the preparer interviewed to ascertain whether Figure 1 proves to be true.

Several challenges may present themselves for preparer’s preparing high-quality financial statements as their financial resources may be more restricted than large-cap firms. These challenges could exist irrespective of whether small- and mid-cap firms are motivated to produce high-quality AFS or not. The challenges may include, but not limited to, restricted sizes of finance teams, attracting and retaining talented financial staff, obtaining sophisticated I.T. systems and the sophistication of their internal audit function and audit committees. The research will focus on gaining an understanding of preparers experience in the financial reporting process to identify if these and other challenges are present.

The quality of the external audit received by small- and mid-cap firms may also be affected if small- and mid-cap firms are primarily audited by non-Big 4 audit firms, or if Big 4 audit firms place less focus and attention on their smaller clients. The quality of the audit could also be affected by the quality of work produced by small- and mid-cap firms. If lower quality financial information and statements are produced, this may cause inefficiencies in the audit, decreasing the potential value-add that the audit could provide the client with. It will also be important to gain an understanding of preparers experience with their auditors as well as the experience of external auditors with small- and mid-cap firms.

Regulators and academics will also be interviewed to discuss their experiences and opinions of the above aspects to gain an independent view on the research.

3.1. Overview of method

The study adopted a qualitative method as its purpose was exploratory. Data were collected from 11 semi-structured open-ended interviews (Creswell, 2009, Rowley, 2012). This was an exploratory study since research on the challenges to produce high-quality financial statements at present is limited, especially with regards to small- and mid-cap entities. Interviews allowed the researcher with the ability to extract rich detail on the challenges faced and was an appropriate form of gathering data for an exploratory study (Rowley, 2012).

A thorough literature review was conducted and 4 existing theories (resource dependency, stakeholder, agency theory and the reputation effect) were used to develop an initial framework, as shown in Figure 1. The framework explained factors which can potentially contribute to a company producing a high-quality set of financial statements, or low-quality set. The coding process was iterative with refining codes and the final framework was refined following the complete data analysis. The interview agenda remained the same for all interviews.

The remainder of the chapter expands on the chosen research method. Section 3.2 discusses how the research data was collected through interviews. In addition, Section 3.3. explains how the detailed interviews were conducted, including the interview agenda and questions. Section 3.4. lays out the population and sample used. Finally, Section 3.5. and 3.6 discuss how the data was analysed and quality of research was ensured respectively.

3.2. Data collection

Data were collected via interviews with preparers, auditors, academics, and regulators. This form of collection allowed for the participant's perspectives to be discussed in more detail than what they would be able to in forms such as surveys and questionnaires (Creswel, 2009, Onwuegbuzie et al., 2010, Alvesson, 2003, Rowley, 2012). Interviewees were given the opportunity to clarify any ambiguities that the interviewer identified (Creswell, 2009, Parker and Roffey, 1997, Rowley, 2012). Tone and non-verbal ques were noted and used when interpreting interview transcripts during the analysis process to develop open, axial and selective codes (Parker and Roffey, 1997, Creswell, 2009, Onwuegbuzie et al., 2010, Alvesson, 2003).

3.3. Detailed interviews

The questions asked to interviewees were neutral and non-leading. This enhanced the validity of the responses acquired (Creswell, 2009, Strauss and Corbin, 2008, Rowley, 2012). Interviewees were also asked to reword their statements to address the possibility of rehearsed responses and ensure there was no ambiguity (Alvesson, 2003).

Once a potential interviewee agreed to participate, a confirmation email was sent. This email included an interview agenda, which is shown in Appendix 4. It allowed participants to prepare and readily discuss their views without increasing the risk of rehearsed responses (Creswell, 2009, Alvesson, 2003, Rowley, 2012). This also assisted in continual improvement of the framework and data collected (Parker and Roffey, 1997, Strauss and Corbin, 2008). The letter further included the participant information sheet and consent form that needed to be completed before each interview commenced (Creswell, 2009, Leedy and Ormrod, 2013, O'Dwyer et al., 2011, Alvesson, 2003).

Two pilot interviews were conducted to ensure the interview agenda: (a) gathered information necessary to address the research questions, (b) was non-leading, (c) did not pose an ethical risk to both interviewee and interviewer, (d) questions were not ambiguous and (e) were complete (Leedy and Ormrod, 2013, Rowley, 2012).

At the start of each interview, it was confirmed with the participant if they had signed the consent form (Appendix 3) and he/she was reminded that the interview is voluntary, can be stopped at any time and that the interview is strictly confidential. The interviewee was encouraged to be open, honest and frank in all responses. Permission to record the interview was part of the consent form. The interviewer took notes on notes of non-verbal ques, pauses and the interviewer's initial reactions, impressions[3], emotions and thoughts and documented them to enhance subsequent coding and analysis. This process formed an important aspect of the theory development (Parker and Roffey, 1997, Strauss and Corbin, 2008, Onwuegbuzie et al., 2010).

The interviews ranged from 60-90 minutes. All interviews were allowed to progress naturally which allowed for interviewees to provide more detail and emphasis on the areas they see fit. A more detailed interview agenda was used by the researcher to ensure that all themes were successfully explored in each interview. Due to COVID-19, all interviews were conducted electronically.

3.4. Population and sample

Purposive sampling was utilised to identify potential interviewees. Purposive sampling was used so that the researcher could choose interviewees who had the maximum probability of providing useful information and provide meaningful insights about the challenges that these firms are facing. This sampling was based on which categories of interviewees can provide the maximum

[3] This ensues interviewer reactions and impressions are not presented to the interviewee which may affect their responses.

meaningful insights on the challenges small- and mid-cap firms are facing (van Zijl and Maroun, 2017). These categories were refined into 4 groups.

For the preparer respondent group, as seen in Table 2, the sample was selected from companies which consisted of being debt listed and others equity listed to get coverage to identify the potential cases which may be present per Table 1. The sample was biased towards preparers of small- and mid-cap firms, since they have direct involvement in the financial reporting process and are closely connected to the struggles that small- and mid-cap firms face in producing high-quality financial reporting. Rowley (2012) proposes 12 interviews while Guest et al. (2006) proposes 30 before data saturation is reached. This thesis planned for 10-20 interviews and conducted 11. Refer to Table 2 for the interview breakdown.

Table 2: Interviewee breakdown by group			
Respondent group	**Population description**	**Sample**	**Reason for inclusion**
Preparer	Chief executive officers, chief financial officers and senior financial managers at small-mid cap JSE listed entities	10 – the purposive sampling attempted to obtain interviewees from the maximum number of difference industries to ensure a rich and diverse dataset.	This population is directly involved in the monitoring and preparation of financial statements. They were expected to have holistic, yet intricate, experience with the details of their company, such as the resources that they have and the challenges they are currently facing in preparing financial reports. As the executive/senior accountants, they were expected to be aware of the experiences and challenges of their junior colleagues.
Auditor	Audit partners and managers of small-mid cap JSE listed entities	1-5	This population was expected to be able to corroborate or contradict findings from the preparer's category.
Regulator	IASB, JSE, IRBA and SAICA members/representative.	1-5	Regulators helped corroborate or contradict preparers' and auditors' responses. These helped to identify any bias.
Academic	Academic CA(SA)s with at least 10 years' experience.	1-5	Academics assisted in grounding the interviewee responses overall. They were expected to be the least biased and most theoretical.

3.5. Interview data and analysis

Interviews ranged between 60–90 minutes, but this did not change because of the COVID-19 pandemic. Each transcript was reviewed to become familiar with its content. Open coding was then performed. A line-by-line approach was used to code each transcript while referring to the literature review to ensure a detailed open coding process. As additional interviews were conducted and coded, previous open codes were refined, resulting in open coding being an iterative process (Strauss and Corbin, 2008, Gibbs, 2010). Axial coding was then performed. The model summary in Figure 1 provided the axial codes. This allowed the researcher to identify links between the open codes (Creswell, 2009). These meaningful links were used to create categories of information which may further be refined by collapsing or expanding them. This process provided a data mind map of categories which formed the basis from which selective coding was done. The coding was used to identify any additional themes or issues emerging from the interviews which shed light on the challenges small- and mid-cap firms are facing when producing high-quality reports (Strauss and Corbin, 2008, Gibbs, 2010).

The data gathering and coding processes were iterative and occurred concurrently. As more interviews were conducted, and codes refined, previously coded interviews were updated to ensure consistency and that the maximum value from each transcript was extracted (Maroun and van Zijl, 2016).

Table 3: Individual interviewee breakdown

Respondent group	Respondent code	Experience	Role and business title	Length of interview (rounded off to the nearest 10 minutes)
Auditors	**A1**	12 years	Senior audit manager	60
	A2	7 years	Audit partner	60
Preparers	**P1**	30 years	CFO	60
	P2	16 years	Group financial manager	60
	P3	17 years	CFO	60
	P4	+/- 20 years	CFO	90
	P5	8 years	Financial manager	90
	P6	25 years	Head of finance and Company secretary	90
	P7	+/- 20 years	Financial director	75
Regulators	**R1**	30 years +	Previously on IASB.	60
Technical accountants	**B1**	20+ years	Previous technical partner	60

3.6. Research quality

Research quality in qualitative studies is slightly different from quantitative studies. Instead of validity and reliability measuring the success or failure of the research study, other factors are used such as, credibility, transferability, and trustworthiness. In the context of qualitative research, controls were used to enhance the credibility, transferability and trustworthiness of the information gathered from the interviews (Golafshani, 2003, Anderson, 2017). These controls were:

- The interview agenda was grounded in the prior literature to ensure that the researcher's understanding over the potential challenges small- and mid-cap firms faced in the financial reporting process was appropriate.
- In order to maintain validity and reliability of the data gathered during the interview process, the interviewer avoided asking leading questions (Alshenqeeti, 2014).
- The supervisor attended all interviews and reviewed the coding of a sample of transcripts. This allowed the supervisor to act as the member checker by ensuring that (1) the analysis and interpretation was consistent and (2) the research provided a fair representation of the interviewees responses (Anderson, 2017).
- The interviewees were primarily preparers at small- and mid-cap firms who are involved and have substantial experience in the financial reporting process of these firms. The other interviewees are subject experts in their fields. This ensured that information was collected from only experienced and knowledgeable persons (Alvesson, 2003, Rowley, 2012).
- Each interviewee was interviewed privately, rather than in a group setting where the honest and candid responses of the candidate could be affected (Creswel, 2009).
- The interviewees were guaranteed confidentiality to enhance likelihood of providing detailed and complete answers to the interview questions (Alvesson, 2003). This assisted in obtaining genuine responses and allowed for the topics to be explored fully, improving the quality of the data obtained (Alvesson, 2003, Rowley, 2012). To prevent ambiguity, or misinterpretations of comments, respondents were also asked to rephrase statements (Alvesson, 2003).
- The questions asked were semi-structured, open-ended and non-leading (Alvesson, 2003).
- In order to reduce the risk of rehearsed responses, participants were not provided with detailed questions prior to the interview (Alvesson, 2003).
- The interviews were recorded to allow for the interview to be uninterrupted and for the researcher to take note of any non-verbal cues and initial impressions, after first obtaining permission from the interviewee. The risk of transcript error was reduced by this process (Creswell, 2009, Parker and Roffey, 1997, Onwuegbuzie et al., 2010).
- The coding process was designed to be flexible while allowing for systematic analysis of data. Axial codes were identified from the prior research to provide structure but open codes were not been pre-defined in keeping with the exploratory aim of this research.

Selective coding was also used to identify interconnections among axial and open codes and reveal any additional challenges which had not been considered by the prior research.

3.7. Research ethics

Research ethics are crucial, especially in qualitative studies. Audio recordings and transcripts were kept strictly confidential through physical and logical access controls. They will be kept for 3 years and then will be destroyed. There will be no public access to the recordings and the transcripts. Their confidentiality was further guaranteed in order to enhance detailed and authentic answers to the interview questions (Alvesson, 2003). The results from the interviews have been organised in such a manner that readers will not be able to link quotations to the particular individuals. Care was taken by the researcher when writing the report to ensure that it is not biased. Interviews were only conducted once ethical clearance was obtained. This authorisation provided assurance that the appropriate procedures have been followed and that the study had been adjudicated by an independent committee as conforming to ethical standards.

4. Results

High-quality financial statements are usually achieved as the reports' ability to communicate the financial movements and economics of the business is improved. There appears to be an overall sentiment shared among the preparers interviewed that either IFRS has lost its relevance, or is on the path to losing it. This appears to have had a negative impact on the attitude to preparing these financial statements by the majority of preparers interviewed.

According to the resource dependency theory, irrespective of whether there are few investors or many, it appears that the users of small- and mid-cap firms are not demanding high-quality financial statements. Users are typically focusing on other sources of information for financial performance metrics to monitor management stewardship and business performance. They usually use the financial statements merely to provide credibility to the numbers incorporated in the other financial performance metrics utilised by them. Otherwise, they tend to use only the basic figures from the financials[4]. As the financial statements are not forming part of the primary source of information for their users, small- and mid-cap firms' motivation to produce high-quality financial statements is decreased further. However, no users were interviewed as part of the research and so generalisations in this regard cannot be made about the users of the financial statements of small- and mid-cap firms.

Small- and mid-cap firms tend to have significantly lower available resources than their larger counterparts. This may be affecting numerous aspects of their corporate governance structures, which has a resultant effect on their ability to produce high-quality financial statements. The finance teams of small- and mid-cap firms are typically smaller and less qualified, with access to a smaller pool of knowledge. They generally struggle to attract highly experienced and skilled personnel. They also appear to have little motivation to attract talented staff and grow talent within the business, nor to improve their current personnel's IFRS knowledge. Similarly, their ability to attract highly talented audit committee members and chairs is negatively affected by their limited resource availability. Overall, the finance team, IAF and audit committee typically comprise of less expertise, which singularly and in combination with each other, can pose challenges to the quality of the financial statements.

[4] The basics include the audit opinion, profit or loss, and current and non-current assets and liabilities.

These 3 components often negatively affect the quality of the work assessed by the external auditors. As work tends to be incomplete and inaccurate, the auditor-client relationship becomes difficult. At the same time, due to their smaller size, small- and mid-cap firms may be more likely to receive audits from non-Big 4 audit firms. This is likely to decrease the ancillary services these small- and mid-cap firms receive from the external audit that may otherwise aid in continuously improving financial reporting quality. Non-Big 4 audit firms typically have less access to resources to enable them to assist in tailoring the financial statements to the entity. Big 4 firms may in a better position to provide additional services which could improve the quality of the financial statements more. However, Big 4 audit firms may be less motivated to provide addition ancillary services or ‘value-add’ to smaller listed clients. This is due to the extra time required to get the basics right and the lower audit fee. As a result, the audits received by small- and mid-cap firms may have less focus on improving the quality of the financial statements, above ensuring a minimum compliance with IFRS before signing off the audit opinion.

As investors and society are generally impacted less by these smaller businesses[5], the lower quality that tends to be produced by small- and mid-cap firms either is going unnoticed or is not attracting enough attention to demand a change in the quality of the financial statements produced.

However, there are 3 factors that could enable the finance team at small- and mid-cap firms to be equipped with the necessary information and knowledge required to produce high-quality financial statements – despite them not possessing the best skills in their industries. Firstly, small- and mid-cap firms are inherently less complex and smaller in nature. They may not require the best managerial and human capital capabilities for high-quality financial statements to be produced. Secondly, these firms usually have a smaller hierarchical structure. Preparers are likely to be closely involved in the operations of the business and obtain a holistic understanding of the various operations. As a result, communication costs are likely to decrease while a thorough understanding would be obtained. Lastly, preparers at small- and mid-cap firms often have longer tenures because of the non-financial benefits that are usually provided at these firms. This will improve their understanding further.

[5] The major pension funds and average individual passive investors typically focus on Top 40 companies.

4.1. Observations of financial reporting

4.1.1. High-quality financial statements vs low-quality financial statements

Some consensus was found over what constitutes high-quality financial statements. Preparers 1, 2, 4, 5, 6, 7 and R1 explained that, at a minimum, financial statements must be compliant with IFRS, have no casting or referencing errors, be presented clearly and well formatted.

> "It's got to be compliant - that's a minimum" P4.

> "Even in JSE-listed companies, you can find things that don't cast or add up… Where the report is all over the place and not well thought out, I think that to me would be a sloppy set of financials" P2.

> "If you look at something and the page numbers are all over the show, that things are just in the middle, it just isn't right, it makes you look at it and say, 'Yes, we need to look at this carefully because it doesn't look like a professional person did this'" P7.

This is in agreement with Biddle et al. (2009), Tasios and Bekiaris (2012) and Cohen et al. (2004) who expressed that compliance, clear presentation and format increase the quality of the financial statements, but from which further quality is still required.

It appears that high-quality is only achieved once preparers have exceeded the requirements of IFRS's minimum disclosure. Providing only the minimum required disclosure appears insufficient to provide meaningful context on the business and for it to become relevant to the users. Quality tends to improve as additional *relevant* information is presented. In addition, high-quality AFS successfully communicate the past financial year's balances, performances, and cash flows in an understandable and concise manner. This indicates a level of thoughtfulness by the preparers and a culture of constant improvement.

> "High-quality financial statements are those that go beyond complying with the basic minimum. Presented additional information that is of **relevance to investors**" R1, emphasis in original.

Quality can be improved through techniques that enhance the logical flow and understandability of the financial statements. Logical flow refers to the ability for users to connect the numbers with corresponding disclosures and removing unnecessary complexities. This assists in making the financial statements more comprehendible. Most prepares believe that the intended users of IFRS financial statements do not possess the necessary IFRS competencies to fully utilise them.

> “If you look at last year’s [AFS], and you ask the trainees to please go review that to get an understanding of the business, more than 70% of the audit trainees come back and they still don’t understand the business based on the financial statements because it is just too complicated or it doesn’t give the correct context” A1.

In addition, interviewees believed that even those users with strong IFRS competencies themselves struggle to comprehend financial statements. Auditor 1 noted that audit trainees, who should be the most technically competent and up to date having just passed their degree and SAICA's Board exams, seem to struggle with understanding the business from the financial statements. Merely understanding the technical aspects of IFRS does not always equate to the user understanding IFRS financial statements. This implies that the manner of communication is important regardless of a users’ personal IFRS competency. Therefore, a high-quality report should enable all these users to understand the business.

Preparing financial statements in a concise manner assists the user to navigate and comprehend its contents. This can help readers remain focused and interested throughout reading financial statements which also assists in improving their ability to extract meaningful information from the financial statements. If the financial statements are not concise, users tend to extract less useful information. A balance must be struck to ensure relevance is maintained without the financial statements becoming overly lengthy.

> “[If my attention is not maintained], then I go: ‘Okay, well that’s nice’ [and] you put it down. Then that 300-page document does not become relevant because I don’t finish it” A1.

Attention can be maintained by presenting items in the financial statements according to materiality. This can be done by preparers identifying, on an annual basis, the information that would be of the most importance to the reader. For example, items which have had noteworthy changes from the past year. These items could be placed first, to direct the readers’ attention towards them. Items which have remained the same, can be placed later in the report as they require less of the users' attention.

> "I think it's also the way you order or present your financials – show your most material notes up first" P2.

Disclosures and commentary can be adapted to add meaning and relevant information about the business, while assisting the users' understanding of the disclosure - rather than disclosing standard 'boilerplate' templates.

> "We actively used to recommend to companies to move away from boilerplate policies because we felt that it doesn't actually add to the quality of the financial statements" B1.

It seems that irrespective of the time taken to prepare financial statements, their level of quality may differ. Most interviewees agreed that timeliness is not correlated to the quality of the financial statements. One would expect that the sooner financial statements are published after year-end, the more relevant they will become, and the increase in relevance would increase the quality of the financial statements. Similarly, the longer they take to be published after year end, relevance would decrease as they are moving further away from when those events occurred. As relevance decreases, quality is likely to decrease as well. The effect of timeliness on relevance and consequently quality may not be sufficient to warrant companies to shorten their deadlines.

> "I don't know if I would put [timeliness] under the quality heading. I've seen many companies produce fairly shocking financial statements one month after year-end. I've equally seen [laughter] companies produce fairly shocking financial statements 6 months after year-end" B1.

Preparers 5 and 6 explained that accountability and transparency of the company in its financial statements aids in increasing the quality of the financial report. Transparency can enhance the credibility of the financial statements, which can provide comfort for users to rely on them. The financial statements could become higher quality as they consist of more acceptable information. This in contrast to Tang et al. (2008) and Preparers 1, 2, 3, 4 and 7 who stated that there is a need for reports to be transparent before quality can be considered.

> “I appreciate a balanced financial statement that can give positives as well as negatives in equal measure – I don't like it when I read financials that have only the positive news and when there is clear negative news, for example covenant breaches or bad trading, there's only a positive spin on it” P4.

Overall, sentiments that the above techniques improve the quality of the financial statements are consistent with Elbannan (2011), who found that the quality of a report is proven by its ability to communicate the underlying economics of the business.

4.1.2. The relevance of IFRS annual financial statements in today’s era

Despite whether financial statements are high-quality or not, there are also concerns over the relevance of IFRS financial statements in general and, more specifically, for smaller listed companies. As accounting has evolved and developed in response to the events and changes in the environment, it appears to have moved further away from remaining relevant to the users of the financial statements (Gea-Carrasco, 2015, Maxxia, 2019). Sixty four percent of respondents felt strongly that IFRS financial statements are quickly, if not already, losing their relevance. A further 27% stated that they believe IFRS, on its current trajectory, will lose its relevance in the near future. Only 9% of respondents felt confident that IFRS financial statements are still relevant. It was evident in interviewees’ demeanor that the lack of belief in the relevance of financial statements negatively impacted their attitudes to the preparation of IFRS financial statements. Preparers may not allocate as many resources to producing IFRS financial statements. Small- and mid-cap firms may be further encouraged to allocate minimal resources to the production of financial statements. This appeared to be adversely affecting the quality of the financial statements produced.

> “There is so much detail and long words included that I don’t think anyone reads it [the financial statements] anymore. So, I do think it has lost relevance because it has just got a little bit over the top… So, you know it has just become such a tick box exercise. It has become so detailed. It has lost that focus” P3.

> “In the 2 years I've been here, I’ve never received any question on that whole annual report – not one. Not from an outsider… not from an outsider or shareholder or anything like that…I just feel that the contents of the annual report are **just too large** [gasp]… I don't even know if anybody reads all that stuff” P7, emphasis in original.

Eighty two percent of interviewees believed that the increased complexity, onerous provisions and disclosure and general cumbersome nature of IFRS AFS are some factors reducing its relevance. IFRS may have become inherently complex over the years. Preparers of small- and mid-cap firms may not spend as much time understanding new standards or obtaining training to enable them to implement them appropriately, since they struggle to see the benefit of it. When asking interviewees on whether they are sent on training, P7 responded “No, not really.” By not obtaining a thorough understanding of new IFRS standards, it would naturally result in preparers seeing them as complex.

Small- and mid-cap preparers interviewed believe that the IASB’s attempt to achieve maximum accountability and transparency, with the aim of improving relevance, has rather resulted in IFRS no longer providing a true representation of what is occurring within the business, in accordance with Maxxia (2019) and Gea-Carrasco (2015). Small- and mid-cap preparers iterated that this has caused disclosures to become cumbersome and complicated, without adding value. Again, this may be linked to small- and mid-cap preparers not always obtaining training on the new standards. Preparers 5 and 6 contradicted themselves by stating this, as they previously explained that accountability and transparency improves the quality of the financial report by enhancing the credibility of it. This may imply that the heightened requirements of IFRS are not decreasing the relevance, but rather, small- and mid-cap preparers may be frustrated by the increased workload that it now entails to prepare the financial statements.

> “It is a simple example on trade and other receivables. That used to be half a page of disclosure, very straight-forward – this is what are risks are, this is our provision for doubtful debts, and the users could see: ‘Yes, that’s what they owe, that’s how much money they are owed, that’s how much they are planning to not be recovered, that is where their risks are.’ Now, that same note is close to 2 pages long. There is so much detail and long words included, that I don’t think anyone reads it anymore. So, I do think it has lost relevance because it has just got a little bit over the top” P3.

Interviewees emphasised how the increased complexity and volume of disclosures required by IFRS has increased the time it takes to prepare the financial statements as well as the time it takes for the users to read the financial statements. The increased time it takes to read financial statements may distract the users from the information that is of importance. As they may then not extract all the necessary information, their understandability of the entity and its performance could decrease, which would decrease the quality of the financial statements. This corroborates the factors found to improve the quality of financial statements. It requires the preparers to create statements which often neither they, nor their users, usually utilize for decision making related to the business. Preparers of small- and mid-cap firms felt that there is a discrepancy between the cost-benefit between the value obtained from the financial statements and the amount of time and effort that is required to prepare them.

Small- and mid-cap preparers explained that when discussing their financial results with analysts, creditors and shareholders, the financial statements are usually not a focal point in those discussions. Instead, management accounts, cash flow reports and key performance indicators form the bases of those discussions. The financial statements are merely referenced to explain where the numbers were derived from and link to IFRS. This is specific to small-cap companies, where conversations not based on financial statements can occur with less risk of contravening anti-insider trading regulations. Large-cap firms would likely be unable to disclose information to selective shareholders, without upsetting the remainder shareholders. Interviewees emphasised that users are concerned with the management accounts and related information and not the annual financial statements. The seeming lack of the use of the financial statements by users contributes to preparers' interviewed questioning the relevance of IFRS.

> "They've got their models… If you look at analysts, they have got their own models… They look at your EBITDA and they understand your segment report and you don't get asked anymore questions. I have never been asked a single question in a roadshow about the liquidity risk or sensitivity analysis on my trade receivables" P3.

To illustrate, P7 argued that her financial statements are not read in detail by retelling a story of an error that was never picked up over many years. This incident supported P7's belief that the preparation of IFRS financial statements (1) is a non-value adding activity, (2) are not relevant and (3) have little value to their users. All small- and mid-cap preparers interviewed shared the same sentiments. These attitudes could result in treating the preparation of the statements as a compliance exercise. If this occurred, it would be likely that minimal resources would be allocated to communicate the underlying economics of the business, and rather only compliance with IFRS would occur. Based on the previous discussion of quality, this would result in low-quality financial statements.

> "No one will actually notice if we make a mistake and slip up" P7.

All preparers constantly iterated that statutory disclosure as per IFRS is not sufficient for users to understand the business, which seems to have led to their belief that IFRS financial statements lack relevance. However, IFRS states that additional information is required to be disclosed to users to assist in their understanding (IFRS, 2020). It may be that preparers are frustrated with the other components of IFRS, that they have forgotten the additional requirements of IFRS which assist in its understandability.

> "I mean they [users of the financial statements] would look at the key numbers and that but if we didn't put in segmented reports and value-adding information, it would be pretty much useless to understand the business… I mean, if I just committed to pure statutory financials without value-add, you wouldn't have a clue of what is going on in the business" P1.

Further, TA1, R1, P1 and P2 are the only interviewees who believed that the disclosures added to the relevance of the financial statements.

> "For me, the accounting policies do have the potential to enhance the quality [of the financial statements" TA1.

Preparers 1 and 2 were preparers of a firm on the border of becoming a large-cap firm. Their opinion on disclosures indicates a contrast in perception to the remainder small- and mid-cap firms. The remainder small- and mid-cap firms' preparers explained that they could not see the benefit in the disclosures required by IFRS. They may not see the benefit because all preparers, other than P1 and P2, were utilizing standard boilerplate templates. Based on the quality discussion, boilerplate templates typically do not add much context to the business, and these preparers would then be correct in perceiving their disclosures as not adding value. Although, neither of the other preparers interviewed had yet corrected this issue to improve the understandability of their financial statements, despite being aware of it, with P7 expressing no desire to in the future.

Technical accountant 1 believed that the performance metrics (such as key metrics and ratios) cannot be solely relied on for communication to users. He believed that until a set standard is created to govern how non-IFRS performance measurements are calculated and the items within them are defined, their reliability is insufficient in comparison to IFRS. IFRS financial statements may then still be a necessity for the verifiability of the values communicated. This could indicate that if there are no standards governing other financial performance metrics, IFRS financial statements could remain relevant.

> "Every time I see a non-IFRS performance measure, the first thing I'm looking for is the definition of it to see how many of the expenses that would normally meet the definition of an expense under IFRS have been excluded?" TA1.

4.2. The challenges small- and mid-cap JSE-listed firms face in producing high-quality financial statements

4.2.1. The effect of smaller and less qualified finance teams in small- and mid-cap firms

The typical size of the finance team is notably smaller at small- and mid-cap companies than at large-caps. The large-cap firms often have finance teams of up to 30 employees dedicated to producing the financial statements across the group, with qualifications of CA(SA), CFA and actuarial scientists.

> "The large-capped firms typically have teams of between 15 and 30 people… Each finance team member is considered to be an expert in their area [of IFRS]. For example – employee benefits, there would be one person who would know everything about employee benefits" B1.

The small- and mid-cap firms interviewed had finance teams comprising of 3 to 4 people, where 70% had CA(SA) qualifications and 30% had BCom's or less.

> "[Small and mid-cap firms] typically have a CA within the organisation or maybe a couple of CA's. A few CA's – let me not say a couple of CA's. But it is definitely not at the same level as what you will find within some of the larger organisations" B1.

> "'When I took the job, I thought it was just the financial managers' position but by the time I went there, I learnt the position was a full financial director position. On the first day I

> went to the CEO and said, 'I'm not a financial director, honestly I'm not.' I only have a BCom, I'm not a CA… I have never drafted financial statements before." P7.

It is apparent from P7's experience that small- and mid-cap firms could be prone to employing finance employees who are not sufficiently competent and experienced in preparing financial statements. This could have a direct adverse impact on the quality of the financial statements that are then produced by them.

Large-cap entities typically have a significantly larger pool of knowledge, than of small- and mid-cap entities. Small- and mid-cap firms tend to have smaller finance teams, with less diversity, financial expertise and talent. This is consistent with what Appelbaum and Shapiro (1991) found in North America. The presence of finance teams with lower qualifications in small- and mid-cap firms is also indicative of what occurs in the public sector. This follows the same trend that Delfgaauw and Dur (2010) found: the relative attractiveness for small- and mid-cap firms decreases, as the financial expertise, education and managerial ability of the employee increases.

While small- and mid-cap firms appear to have smaller finance teams, they do typically have smaller operations with less complexity. As such they may not require large teams with extensive knowledge and experience. Despite this, IFRS is seeming to become increasingly complex. . Irrespective of the size of the firm, it now appears that it may be necessary to have qualified CAs who have the sufficient experience with IFRS to prepare the financial statements.

> "The fact that I'm not a CA, there are a bit of limitations because sometimes, when they talk about things, I don't know what they're talking about" P7.

4.2.2. Small- and mid-cap firms' ability to attract and retain talented finance teams

An important determinant in attracting high-quality financial expertise is resources. Small- and mid-cap firms, as one can reasonably expect, cannot always offer the same level of financial compensation as their large counterparts, in line with Appelbaum and Shapiro (1991).

However, there are other qualitative factors which contribute to attracting staff. All preparers at small- and mid-cap listed firms interviewed, expressed that working at a smaller firm can offer a better quality of life and a work-life balance. These firms often provide opportunity for promotions and financial stability as they are still large enough to have stamina against adverse events. They may also provide greater exposure to many aspects of the business by often being holistically involved in the operations. At large-cap firms, preparers are more likely to be focused on a single department, subsidiary, or accounting area. There tends to be opportunity to have direct contact with the board. Generally, a higher level of autonomy is allocated to employees. These characteristics are consistent with those that Appelbaum and Kamal (2000) found to be attractive in small and medium sized firms. At a large-cap firm, one might receive exposure to more complex transactions, but one might not have the same diversity in work exposure, since the role is often restricted to a specific area. With the smaller size, employees are also in the position to build stronger relationships amongst their team which results in trust being developed between co-workers. Depending on what individuals' value most, these non-financial benefits could be more attractive than the financial benefits a large-cap would offer.

> "One of the big negatives of a very big firm is that the decision making happens at so many levels above you. And I think people who have been in big firms realise that. In comparison to here, [we] have a lot of decision-making power. [We] can end up making decisions and be backed [by our superiors]. It is those softer types of things that are important [to me]" P1.

> "There are growth opportunities and being in a smaller team has lots of benefits when you are in a team… where you are able to trust them" P5.

> "Working for a small team in this type of office environment where there is maybe more flexibility, and trust and ownership that goes with that is quite different from working perhaps at [a Top 40 listed company] where you are in a silo who reports to someone who reports to someone else. So, I think that also comes into the equation in terms of attracting and retaining talent" P6.

> "I have direct access to [the CEO], for example, who's on a listed board. How many companies would I get to work with where I can engage with [the financial director] on a daily basis, as a director of a listed company? Probably not many" P6.

The typically longer tenures of the finance staff at small- and mid-cap firms may have a positive effect on the quality of the financial statements produced. High-quality financial statements are usually achieved when the financial statements are adapted to be specific to the entity's business, are concise and successfully communicate the economics of the entity in an understandable manner. The lower the staff turnover in the finance team, the more experience these staff will gain in their role and in the firm. This experience would enable the preparers to have a thorough understanding of the business, which would better equip them to prepare high-quality financial statements, irrespective that they may not be the most talented within their industry. As there is often a lower hierarchy of employees within small- and mid-cap firms, the finance team are likely to be more directly involved in the daily activities of the firm. Consequently, small- and mid-cap firm preparers are likely to have direct access to local information and changes in this information. This would decrease the amount of information that would need to be communicated to these managers from the bottom of the hierarchy. As a result, information-processing costs are likely to decrease, including: costs of communication, costs of miscommunication and opportunity costs from delays in communication (Gurbaxani and Whang, 1991). This in-depth understanding and direct access to information could decrease small- and mid-cap preparers' challenges and assist them in producing high-quality financial statements, irrespective if they have less financial expertise.

One hundred percent of small- and mid-cap firm preparers interviewed believed that the size of their company does not justify the expense of having a large finance team, nor a more qualified and experienced finance team. They explained that a higher level of expertise would not benefit their daily operations, resulting in the cost outweighing the benefit – irrespective of whether they were restricted by financial resources.

> "I don't think employing a person that knows all these things and to then pay them R100 000 a month is worth it for our company - because we would only use it when we have to do these wonderful calculations at year-end… I don't think for a small company like ours it's… I don't think it is worth it" P7.

The preparers of small- and mid-cap firms interviewed believe that they have the necessary skills to manage the finances and accounts. Yet, they do express the distress that IFRS causes them and admitted their struggles in understanding it. There has been consistency in the standards that have been raised as particularly difficult to apply. One hundred percent of small- and mid-cap preparers noted that IFRS 16, IFRS 9, IFRS 3 and IAS 20 are complicated. Twenty percent stated that IAS 38 is difficult. As discussed previously, IFRS appears to have become increasingly complex over the years. Preparers in the smaller sector may have had sufficient knowledge and understanding to prepare IFRS financial statements but as the complexity has increased their level of competence and qualifications may no longer be sufficient. It could either be that small- and mid-cap firms are not financially equipped to change their finance team, or they cannot yet see the need to improve their knowledge. Larger-cap firm preparers also believed that they were more than sufficiently equipped with a finance team who had the necessary skills and experience to prepare their financial statements. Unlike the smaller firms, they expressed no distress about the application of IFRS.

All the preparers found that the disclosures were complex. The larger-capped preparers still identified them as necessary while small- and mid-cap firm preparers failed to identify the necessity of them. The contrast between the preparers of small- and mid-cap firms, and that of large-cap emphasises the possible difference in attitude, experience and understanding in IFRS reporting that may exist across the different sized entities.

Eighty percent of small- and mid-cap preparers initially stated that they found no issue with the calculations and only the disclosures were complex.

> “I think the calculations are fine” P7.

As the conversation progressed, P7 began to contradict her initial opinion:

> “Obviously, we should do it better, but I think it's just so complicated [in reference to IFRS 9] that, that [sigh] we tried to look at it a million times and you, you just don't get it. I don't get it… How they calculate the expected credit loss allowance – so that for us is just too complicated” P7.

This indicates the perception that small- and mid-cap firms tend to believe that they are sufficiently equipped to prepare IFRS financial statements, but in fact may not always have the necessary IFRS competencies to do so. This may contribute to them not obtaining training or more qualified personnel.

Majority of small- and mid-cap firm preparers interviewed explained that they had a low staff turnover. Only one firm had experienced a high staff turnover and that was strictly caused by personal reasons. When the small- and mid-cap preparers were questioned about staff turnover, the preparers reiterated the benefit of working closely with a small team. This results in the formation of strong relationships between staff, which decreases conflict and facilitates communication. This may be the reason why turnover is lower than expected. All preparers found that this leaves them feeling satisfied with their jobs, and reluctant to search for work at a large-cap firm. These findings are consistent with Bantel and Jackson (1989) and Baer et al. (2013). A low turnover would assist in producing high-quality financial statements as the preparers would have a more thorough understanding of the business and what is relevant to its stakeholders. However, this benefit might not be brought to fruition if the preparers are not incorporating this thorough understanding into their financial statements by exceeding the minimum requirements of IFRS and presenting additional information relevant to the users.

The best talent still appears to often reside more in the large-cap firms. Either small- and mid-cap firms may have failed to obtain a significant competitive edge with these non-financial benefits or financial compensation may be a larger determinant in South Africa as it is a Third World country (Yousaf et al., 2014). These were the factors Appelbaum and Kamal (2000) and Yousaf et al. (2014) found to result in less talent residing in the smaller-capped sectors. This is also similar to the large banks in Bantel and Jackson (1989) , where the large-cap firms tend to have finance teams that were more educated.

It may also be that the smaller-capped firms typically attract personnel with specific characteristics – ones who are less competitive and ambitious. One would expect that workers who are less competitive, enjoy job security and a work-life balance would reside in the small- and mid-cap sector, and those who are competitive, arrogant and prefer challenges and opportunities to succeed would reside in the large-cap sector (Wong and Chung, 2003, Maslow, 1958). Consequently, there may be lower competition within the small- and mid-cap sector among finance employees. Less diligent individuals may not be removed as fast, unlike in large-cap firms where profit maximisation typically removes ineffective managers. This may be a factor in the lower turnover that was predominantly found amongst the small- and mid-cap preparers. This proves similar to the public sector – as the most talented staff remain in the private sector, so do they usually in the large-cap sector, and as the less educated managers reside in the public sector, they might too in the small-cap sector (Delfgaauw and Dur, 2010).

Technical Accountant 1 explained that he found finance members in the large-cap firms to display characteristics of arrogance and competitiveness, resulting in them constantly learning and improving their technical skills to outcompete their peers. Large-cap firm preparers may also perceive IFRS to be more relevant as they tend see it as a tool to communicate the financial movements within the business. As a result, large-cap firm preparers ensure they have the necessary understanding and training in IFRS standards. This possible enhanced understanding may cause them to respect the financial reporting process more. IFRS would then cause them less distress and financial statement preparation may not be treated as a grudge exercise. There may be less pressure in the small- and mid-cap sector to maintain a high-level of understanding in IFRS, which could lead to individuals who are not constantly improving and increasing their knowledge, influencing financial statement quality. As preparers of small- and mid-cap firms may be less diligent and have less expertise, they typically perceive IFRS to be too exhaustive.

> "It does seem that there is a level of competitiveness amongst [preparers of large-cap firms]. Where there is a wanting to reflect that they are they are better than their peers and at the top of their game from an IFRS perspective... Most of them take personal pride in being strong in IFRS and it seems to be quite an important factor to them" TA1.

As small- and mid-cap preparers appear to have a perception of financial reporting being a non-value adding activity, combined with them seeming to have lower expertise, they do not always see the value in preparing financial statements, and even more so ones of high-quality. This could result in preparers not performing to their professional capacity, as all individuals have an inherent need to believe that their work is meaningful (Maslow, 1958). The quality of financial statements produced could be directly affected by this.

> "It probably is a part laziness, it is probably part 'I don't know how?' and it is probably a part of 'This is going to take me 2 days to do, no one is going to look at the financial statements or no one is going to see the value in actually doing IFRS [when referring to small- and mid-cap preparers]'" A1.

4.2.3. Users of the financial statements

Small- and mid-cap firms tend to have dependence on their equity investors, rather than external debt financiers. Case 2 of the resource dependency theory appeared, where there was a high dependence on a few independent equity investors. This provides these few investors with higher power over the firm. The relationship between the firm and the investors in this instance was described as close. This provides the opportunity for the economic movements within the business to be communicated mainly through management accounts and engagement through meetings and conversations. Where there were investors who did not have significant shareholdings but appeared on the board or were a part of the management of the firm, a close relationship also existed. This was evident where P4, 5 and 6 had most of their shareholders on the board of the company, and where P3 had a significant shareholding. The close relationship can facilitate further inherent trust between the parties. Due to their presence in everyday aspects of the business, they did not require financial statements to fulfil their need for knowledge about the economics of the business. They could rely on the information gained through being a part of management, together with the use of management accounts.

> "We use both audited financials and management accounts and engagement. We have representation on the boards so we're very close to the detail. We rely mostly on the management accounts" P4.

The stakeholder theory looks at which constituencies the firm should be accountable to and states that the firm will typically perform actions to satisfy the needs of its stakeholders (Phillips et al., 2003). The fewer interested stakeholders in the financial statements, the less emphasis one would expect management to place on the production of these financial statements. As per the stakeholder theory, when a close relationship does exist, management would be less likely to allocate resources to producing high-quality financial statements. Per the resource dependency theory, this results in a lower information gap to be satisfied with financial statements. Instead, management appeared to merely satisfy their regulatory requirements.

With regards to the remaining instances, the small- and mid-cap firms interviewed were financially dependent on wide-spread equity investors, which would be the case under Case 1 of the resource dependency theory. Per the resource dependency theory, the high power that investors have over the company would likely necessitates constant representations to be made to shareholders in the form of high-quality financial statements to compensate for the lack of information that is available to them around the financial health of the entity. This did not occur. From the interviews, it appears that users of small- and mid-cap firms tended to not use financial statements to satisfy their knowledge requirements. Preparer 7's company has a wide spread of shareholders. Majority of these shareholders were not largely interested in the financials. The reason these investors are less concerned about the financial statements may potentially be because investors' holdings within them are usually immaterial, and the broader stakeholders are less concerned over entities with a lower impact and influence on society. This contradicts the perceptions of P1 and P2, who are preparers on a larger-cap company. They see interest in their financials from numerous analysts with whom they communicated on a regular basis. Preparers 1 and 2 also never expressed doubt about whether their financial statements were used.

Regulator 1 and TA1 both believed that small- and mid-cap financial statements are not being used, while large-cap financial statements are – sharing the same sentiment as the preparers of the financial statements. More specifically, when it comes to analysts, R1 believes few, if any, are using the financial statements of small- and mid-cap firms. All preparers of small- and mid-cap firms interviewed expressed that the apparent lack of interest in their financial statements leads to them doubting the relevance of IFRS financial statements. Again, this is consistent with the stakeholder theory.

> "So, if you're in a Top 40 on the JSE, it's likely that all the analyst houses are looking at you. If you are on the top 100, well it's not as guaranteed but pretty much you can say that at least half the analysts will be looking at you. When you drop down below there, into the mid-cap and the smaller, most analysts won't even give a comment about the companies because it isn't worth their while to spend time digging and looking at those companies. So, there may be 1 or 2 analysts having taken a particular interest but otherwise not really" R1.

The agency theory details the relationship between the investors (principals) and management (agents). The financial statements are used as a tool to close the information gap between management and provide assurance to the investors over how the resources of the entity are being deployed. One would expect that users would be using these financial statements to hold management accountable. It is apparent in Case 2 of the resource dependency theory that there is a small information gap that needs to be closed because of the close relationship the few equity investors typically have with management. This also appears when investors are a part of management. Despite an information gap present in Case 1 of the resource dependency theory, where there are many equity investors which the firm is dependent on, the financial statements do not tend to be the primary source of information to bridge this gap. Typically, shareholders are using other metrics to hold management accountable for the stewardship of the company resources. The use of other metrics would not decrease the agency costs for the firm, as these metrics are still derived initially from the values in the IFRS financial statements. Agency costs are then decreased for the users, through using other means that are both quicker and easier to use. This presents a further challenge. As principals are likely to give less attention on the financial statements, there is a smaller chance of lower-quality reports being identified by users and, if they are, a little chance society will react severely to them.

> "But like many things, if people don't look at the information then they'll never question the information and that's the big risk for the mid-cap companies, mid- and small- cap companies - that they don't have a dozen analysts looking at their financial reports and other statements all the time. They have 1 or 2 who may ask them questions and so it doesn't actually ring any alarm bells anyway to say there's something going wrong until it really does" R1.

The reputation of the firm is expected to motivate high-quality financial reports and decrease the likelihood of misstatements (Cao et al., 2012). Since the financial statements of small- and mid-cap firms are typically evaluated significantly less by stakeholders, the reputation of their firms may not rely as heavily on the quality of their financial statements. This is in line with the 'reputation effect' by Weigelt and Camerer (1988). This may indicate a negative association between firm reputation and the likelihood of misstatements.

The larger-capped preparers expressed numerous times the importance of financial reporting to earn the trust of their investors and users. They direct significant effort and attention towards their reporting to ensure accuracy and understandability rather than merely compliance. In this they gain confidence from their investors, advisors, and employees. This is a stark contrast to the attitude of small- and mid-cap preparers interviewed, who did not appear to see financial statements to gain trust from their users.

> "And I think the financial reporting also builds a strong relationship with the regulators [and users] so that they understand your business and that, and if there is a challenge, that you end up being able to contact them, and provide additional level of comfort and support for people" P1.

The larger-cap firm was dependent on many users for the provision of finance and the maintenance of a positive reputation. The users of the financial statements of this large-cap firm constantly monitor the management of their performance and the use and allocation of their resources, making agency costs higher to satisfy the high expectations of their investors. This increases the demand for high-quality financial statements. As their reputation is very dependent on their financial statements and the quality of them, they were more incentivised to use their financial statements as a means to enhance their credibility and trust with their investors. They stressed numerous times throughout the interview. As access to resources was less of a challenge for them, they were in a better position to manage their external dependencies and were more motivated to do so per the reputation effect, stakeholder and agency theory. As per the resource dependency theory, this may enable them to fulfil the users' demands and produce high-quality financial reports. This is evident of Case 5 of the resource dependency theory.

However, it is important to note that no users of the financial statements of small- and mid-cap firms were included in the financial statements. Due to such, generalisations around these users cannot be made and the above scenarios can be seen as absolute conclusions.

4.2.4. Sophistication of accounting software at small- and mid-cap firms

The accounting software used by preparers included AccPack, CISPro, Pastel, Sage and Palladium, with all preparers incorporating the use of excel and manual accounting. Their systems and I.T. were not sophisticated.

> "They're not sophisticated enough for the new standards, definitely… So, it's a very cumbersome and rudimentary process…They understand that from an IFRS perspective they cannot work on how they were working. They need to get centralization and they need to have further sophistication in their accounting systems" A2.

The primary reason that they have not incorporated sophisticated software into their accounting processes and packaging tools is probably because of the limited financial resources they have access to. Previously, before IFRS increased in complexity, the accounting software was sufficient. The need to have more sophisticated I.T. has become apparent as reporting requirements have become more complex. Nevertheless, most of the preparers interviewed still do not believe the benefit will outweigh the cost.

> "I think it was more cost perspective and more there was no need for it at that time for them to centralize everything [and obtain sophisticated software]" A2.

Small- and mid-cap preparers may be less motivated to upgrade to more sophisticated software because of, again, the attitude that they may have towards IFRS financial reporting. As they generally see it as a non-value adding activity, they may be reluctant to allocate resources for better software to assist in the process, when their users appear to not demand high-quality financial statements and are generally not obtaining any return from the financial statements.

The lack of sophisticated I.T. systems create another challenge small- and mid-cap firms may be facing. It may reduce the firms' flexibility and prevent them from extracting desired information at granular levels. In addition, this could negatively affect their ability to capture their accounting at a group level. The inability to easily extract information from their systems is likely to frustrate the financial reporting process further, by increasing the time it takes for one to prepare the financial statements. As there is less direct access to information, preparers may be less inclined to obtain extra information to enhance the quality of financial statements produced.

4.2.5. The quality of the external audit and its effect on the financial reporting process

The relationship which exists between preparers and auditors typically involves a significant amount of disagreement and frustration. When P3 was asked to describe his relationship with the external auditor, this was his response:

> "No, it's a pain in the a**e... I mean I say to my wife: 'Okay cool, they are nearly finished their field work, I will re-introduce myself to you and the kids in about 3 weeks' time'" P3.

From the preparers' perspective, the external auditors often come across as too forceful.

> "Yeah, they will say 'That is your opinion, but you know what? This is IFRS.' They always throw IFRS at you and say, 'This is IFRS and this is what you must do, so please go over it and do it again and then come back to us' [in a forceful, unpleasant tone]" P7.

The preparers explained that this results in the audit being an inefficient process due to constant disagreements. Small- and mid-cap preparers may have lower financial expertise over IFRS. They usually are not willing to get training and do not always see the benefit in gaining higher financial expertise. While the auditors cannot assist because of their independence requirements, their relationship with small- and mid-cap clients is often prone to disagreement. Auditor 1 explained that at times she questions whether she is auditing the work or being the financial manager.

An auditor at a Big 4 firm said that audits on larger listed clients were easier, more efficient and did not involve as much disagreement. She explained that the quality of the financial statements received is often higher at a larger listed client. Small- and mid-cap firms' financial statements tend to be less complete with more inaccuracies. This supports the previous discussion that small- and mid-cap firms tend to have less experienced and smaller finance teams. This may not only be affecting the quality of the financial statements small- and mid-cap firms then produce. It may also be contributing to a decrease in audit quality. As a result of the increased time spent on resolving core IFRS issues, less time is available to improve the quality of the financial statements.

> "By the time that you get something from a large-listed client, it is 90% ready, whereas the smaller company, there are all these version control issues, things get done over and over again" A1.

This can be linked to the attitude that small- and mid-cap preparers have on financial reporting. It seems to create frustration as they tend to see it as a pointless and complex exercise. Consequently, the work they initially provide the external auditors may not always be up to standard. Small and mid-cap firms' preparers are commonly reluctant to allocate additional time and effort to adjust the financial statements in accordance with IFRS. This often results in the external audit becoming a time-consuming exercise, potentially decreasing the time to provide additional services to the firms that could improve the quality of the financial statements.

A few interviewees noted a difference in the audit quality of smaller audit firm, compared to a Big 4 audit firm. Regulator 1 and TA1 explained that the Big 4 have a prestige that is attached to their name. They often have a larger workforce and client base which provides them with diverse experience and thus, a greater availability of knowledge. This is in align with Ettredge et al. (2011), Dezoort et al. (2000) and Solomon et al. (1999) and is inconsistent with Behn et al. (2008) who argued that audit firm size does not affect audit quality.

> "It's, you know [hesitation]. In terms of the smaller audit firms, I worry about the... It might be kind of inappropriate to say this, I guess, I know that generally, when you're dealing with one of the larger audit firms, you know that in the same way as the large-listed

> companies have the technical resources and capabilities of people dedicated to doing this IFRS work, similarly the large audit firms have people dedicated to doing this. Whereas, when you look at the smaller firms that do not have that level of expertise and so you know it might be more difficult for those audit firms to, I guess to correctly make, I don't know if there's such a thing as correctly make a call. But to sort of the judge the situation” TA1.

Due to Big 4 firms typically possessing a higher level of expertise and competence, TA1 explained that they are in a stronger position to be comfortable in their decision making around what needs to be in present in the financial statements. This could provide them with more confidence in their judgements. This is supportive of Francis and Yu (2009) and Sawan and Alsaqqa (2013). Auditors who can make better judgements would be more likely to improve the understandability and quality of the financial statements through being better equipped to determine what should remain, be adjusted or omitted from the financial statements.

> “It might just be that the larger audit firms have kind of more of a base tool to be able to cut out some disclosures and say that those we know absolutely are not going to be useful in this scenario and therefore we will be able to completely stand by saying, ‘We thought about this. It was not material. We're moving on with our lives’” TA1.

Non-Big 4 audit firms may experience the same challenges in the quality of their personnel that small- and mid-cap firms do. The Big 4, like large-cap firms, typically hold rich sources of knowledge and attract the best talent with more ease. All small- and mid-cap entities interviewed were audited by non-Big 4 audit firms. Small- and mid-cap firms usually have smaller operations and decreased complexity, which may not warrant the need for the higher expertise that the Big 4 may offer. Since small- and mid-cap firms tend to have fewer financial resources, they may not be able to afford the higher audit fees that are associated with the Big 4. They may then tend to be predominately audited by smaller audit firms. If so, these smaller cap firms may receive lower quality audits from the smaller audit firms. Subsequently, this could prevent improvement in the quality of financial statements they produce.

The small- and mid-cap preparers interviewed no longer see the audit as a value-adding activity. They explained that value-add from their external auditors would incorporate quality time with their auditors, where they gain an understanding of the business, identified issues, provided additional advice on accounting matters and assistance to improve the business. This definition of value-add is consistent with what Fontaine et al. (2013) described to be value-add. Value-add by the auditors may affect the quality of the financial statements produced. With auditors having a more detailed understanding of the business processes they may be in a better position to assist with tailoring financial reporting disclosures to the specific needs of the firm and their users.

> “There is **no value-add**. Not at all. **Seriously not at all**. [sounding very unimpressed] No [laughter in disbelief] seriously, I didn't. We didn’t receive any value-add” P7, emphasis in original.

The numerous scandals involving auditors seems to have heightened pressure which is placed onto auditors for ensuring compliance.

> “I think right across the board they've all got ‘bomskok’ and they all are running shy after all the scandals” P4.

The heightened pressure is a possible contributor to the sudden decrease in value-add. Interviewees expressed that audit firms allocate less time in advising small- and mid-cap clients to add value, which is what all preparers explained assurance previously provided. All preparers expressed the same sentiments on how auditors have increased their testing and displayed fears of non-compliance and threats to their independence on the audit.

> “I just think that the focus on compliance has just distracted from what they can possibly do, and I think the regulator is playing a big stick role, rather than being a ‘How do we help you improve it and what can we do to support you?’” P3.

This may not be the only factor contributing to the lack of value-add at the small- and mid-cap companies. It may also be due to value-add being difficult to provide to smaller listed clients. Auditor 1 believes it is difficult to sell value-add to smaller listed clients because the preparers do not see the benefit due to them typically having a lack of experience and IFRS expertise. This is combined with the audit commonly being a grudge experience, small- and mid-cap preparers appear to be less willing to listen.

> “I don’t think they take seriously what has to go in there or understanding what has to go in there. It’s difficult then to – you can spot then where the inefficiencies are or where you can add value but then it is difficult to sell it, if they do not understand the importance of the accrual as a whole, they won’t understand or see any value-add to it.” A1.

Audit firms may be better equipped and willing to provide value-add to clients that are of the same size as the firm. Auditor 2 believed that value-add is positively correlated to: (1) how material the client is to the firm and (2) whether the firm has the resources to audit the client. He believed that small audit firms would be more motivated to provide value-add to small- and mid-cap clients, because their fees are a significant portion of the audit firms' total income. As the size of the client increases beyond the threshold the firm is equipped to audit, the value-add would decline. Similarly, the Big 4's motivation to add value would increase as the size of their client increased, leading to potentially less value to be added by a Big 4 audit firm to a small- and mid-cap company. However, it is apparent that there are differing opinions between A2 and the preparers interviewed on what value-add on an audit entail. These differing opinions can be contributing to the absence of value-add the preparers interviewed explained they experience.

> "Generally, it depends on how big the client is in relation to the Big 4 firm. If that client is sort of similar in size to the Big 4 firm, right or not similar in size but is large in relation to their total fees or makes up a good portion of their total fees, I think they would be able to provide a much bigger value-added suite of services of course, definitely" A2.

Auditor 1, who is an auditor at a Big 4 firm, explained that she would actively spend more time towards providing value-add at large listed clients. This would be in line with A2's perception that Big 4 audit firms provide less value-add to smaller listed clients. More value might be added on the audits of larger firms by the Big 4 audit companies, than that on small- and mid-cap firms because the larger firms typically can appreciate, listen and utilise the value provided by the audit companies.

> "I would spend more time adding value on a large-listed client than small- and mid-cap clients because I know by the time that I go to them it will be a conversation that would be listened to, in the first place" A1.

If A2's belief was true, small- and mid-cap firms interviewed should share a sentiment that they are still receiving value-add from the small audit firms, since the audit firm size is proportionate to the client size. However, P4, 5 and 6 explained that they did not feel as if they were receiving any value-add from the audit from their non-Big 4 auditor. They also expressed that the value-add received from the Big 4 audit firm was, from their experience, only marginally better than that provided by the smaller audit firms. This supports Francis (2004) who found that Big 4 firms are not consistently superior to but rather, on average, are providing higher quality audits than non-Big 4 audit firms. Preparer 3 and 7 who were audited by non-Big 4 audit firms also iterated that they did not feel as though they received value-add from the audit. This either indicates that (1) non-Big 4 audit firms may not be successfully providing value-add to their clients, and Big 4 firms may be allocating fewer resources to providing value-add specifically to small-listed firms, or (2) neither audit firm may be providing sufficient value-add. If the latter is true, it is likely that the decrease in value-add is because of the shift in audit focus that has resulted from the increased scandals which have occurred.

> "The value-add on the audit is low. It's very low and with our interaction with the Big 4, it is not much better" P4.

Auditor 2 believed that the audit firm provided value-add to their clients, such as training and consultancy services on IFRS.

> "If you are talking about listed clients, they definitely feel like they are getting a value-add and the reason why I can confidently say that is because like I said, we have a very consultative relationship in nature. They consult with us really often on accounting issues, on financial reporting issues, on a multitude of different issues, taxation etc." A2.

When interviewing a preparer who was audited by the audit firm A2 worked for, the preparer still believed that no value-add was being provided from the external audit.

> "Yeah, so audit firms are using training courses and stuff as a value add to try win business or keep business… 'Okay, cool thanks, but where is the value add?' None of it was, none of it added any value. And I think it has just come down to again IFRS, the focus on compliance and hold over the coals of non-compliance for the firm trumps customer service and adding value" P3.

The perception of value-add appears to be the same from both the auditors' and the preparers' perspectives. Preparers interviewed still believe value-add is not being received. Small- and mid-cap firms tend to have relationships with significant amounts of disagreements with their external auditors, and this may contribute to audit firms being less motivated to exceed the minimum compliance on the audit, consistent with Herda and Lavelle (2013). The lack of value-add preparers of small- and mid-cap firms claim they are receiving would affect the quality of financial statements that they are producing. They may not be receiving sufficient guidance from their auditors on the accounting issues that they do not understand nor on how to improve their financial statements for their users (such as adjusting disclosures to aid in the understanding of the business and its operations). If they are receiving this guidance, they may not be using it effectively, due to their negative perception of the auditors. The lack of value-add regarding accounting issues could result in small- and mid-cap preparers producing financial statements that meet the minimum requirements of IFRS but not enhancing their quality.

All preparers of small- and mid-cap firms expressed a concern over the competence of the audit trainees and how they execute the audit procedures. They also expressed concerns that the trainees do not have practical experience, which effects their understanding of the business and contributes to the disagreements. They explained that the audit trainees do not have a thorough understanding of the business that they are auditing, and rather only understand it to the extent that they are required to. The audit trainees appear to have started treating the audit as a checklist exercise. It was found that the checklist approach to the audit often occurred, irrespective of audit firm size.

Audit trainees at Big 4 audit firms may be more talented, but they are unlikely to have more practical experience than those at non-Big 4 audit firms, since they all have come directly from graduating. The possible lack of practical experience of audit trainees may then be apparent irrespective of audit size. Nevertheless, Big 4 audit firms may have a larger pool of knowledge present in their supervisors and technical resources, which could assist their trainees better in overcoming the lack of practical experience. This could influence the quality of the audit provided by non-Big 4 audit firms. The trainees may not have the same resources available to tailor a set of financial statements to the client's business, which appears to be crucial in enhancing the understandability and quality of the financial statements. Further, as there is typically a difference in competence and experience at the supervision level, the Big 4 may be more equipped to identify whether there are material disclosures that have been omitted, or immaterial disclosures present that should be omitted. This would enable Big 4 firms to be less affected by the checklist approach they appear to be applying.

> "And then maybe something else just to describe the auditors that I found - that their audit programs are a checklist. So, I think we've experienced that they don't apply their minds.

> They follow that checklist and by just following it methodically they miss the real issues. It's almost like they are not allowed to think and understand but rather follow the software package of the auditing firm - check list. [laughter]" P5.

> "But, you know, the way that they sit there, that is just what they have been taught and that is what they do. Then you realise, they have never been outside their audit office. They don't understand practice and how it works" P7.

Small- and mid-cap firms generally have smaller audit teams assigned but assigned for a longer period of time. Large-cap firms generally have larger audit teams assigned. More audit trainees on an audit provide more eyes to identify issues. Although, A1 explained that since there are fewer audit trainees on small- and mid-cap audits, each trainee is more heavily involved in the audit process. This enables them to identify issues that otherwise would have gone unnoticed, since they have a more thorough understanding of more aspects of the audit which could improve the quality of the audit.

> "Sometimes, what is nice about having a small team is that everyone is so involved in their sections and you can see loopholes in different other sections. If I am testing cash, intercompany and operating expense, all those 3 things talk to each other. So, if I know, 'Oh there was a problem with intercompany, maybe it was the wrong transfer out of bank and cash.' Whereas, if you had 3 different people on each one of those financial statement line items, you miss those gaps. So, I am a little in two-minds" A1.

Xing (2012) stated that supervision on an audit increases with the size of the audit client. The findings indicate a possible positive relationship between supervision and client size. On large-cap audits, A1 explained that there will be a partner, an associate director and a few senior managers. Whereas on the small- and mid-cap audits, A1 and all preparers stated that on average there is only a partner and a senior manager.

> "So, your hierarchy is that much higher and bigger than on a large-listed client" A1.

On the technical team assigned to the audit client, TA1 explained that the level of supervision is also different. From his experience, a partner is required to sign off for a large-cap listed client, whereas on small- and mid-cap clients, an associate director can sign off.

> "If it was listed client then a partner needed to sign off. But, for smaller clients, if I'm not mistaken, there was the ability for an associate director to sign off, rather than a partner" TA1.

Less supervision has the potential to decrease the quality of the audit, as mistakes made by audit trainees can go unnoticed. However, smaller audit clients should not require as much supervision since they tend to be inherently less complex and there is less work to be performed. Smaller listed clients may not warrant the same degree of supervision as large-listed clients and the level of supervision may then not influence the quality of the financial statements produced.

As previously explained, agency costs are decreased for users of the financial statements when users are less diligent in their analysis the financial statements. Instead, other performance metrics are utilised to hold the firm accountable. Lower agency costs appear to often occur with small- and mid-cap firms. The investors, management and audit committee of small- and mid-cap firms may be less concerned over the quality of the external audit as Arruñada (2013) found that as agency costs decrease, the demand for higher-quality audits decreases. This could result in the audit quality received remaining unchanged.

4.2.6. Sophistication and trend of the IAF at small- and mid-cap firms

The small-cap firms interviewed had unsophisticated in-housed audit functions. Their IAF comprised of the finance team who performed a few internal audit activities. All mid-cap firms interviewed outsourced their internal audit function, and the larger-cap firm interviewed had developed their own in-house internal audit function with permanent employees allocated specifically to the internal audit function. These findings were consistent with the opinions of the external auditors and regulators about the IAF – that it will tend to move from no IAF, to outsourced IAFs and then to sophisticated in-housed IAFs as the market cap of the firm increases.

> "Yeah, very much so [on whether the internal audit would differ between small- and mid-cap companies and large-cap]. I would think most of the small-cap firms, if they have an internal audit function, then it's been outsourced to one of the accounting firms, who will have their own internal audit divisions…

> Once you get a large cap firm, I don't foresee them engaging an outside organisation to come and do their internal audits. They have the ability and the strength to hire people internally and to run their business internally for them” R1.

As the firm size decreases, the more likely the internal audit function will move from being (1) a sophisticated, in-house internal audit function, to (2) an outsourced internal audit function, to (3) an un-sophisticated in-house internal audit function. Hence, small-cap firms commonly lack sophisticated internal audit functions if they do possess any at all. Preparer 7, who worked at a small-cap firm, explained that her company does not see the benefit nor the need to have a dedicated internal audit department, or in obtaining an outsourced internal audit for a company of their size. Again, it appears that limited access to financial resources is the primary challenge. She explained that the cost exceeds the benefit they would receive from the function. The cost of both an outsourced and a sophisticated in-house internal audit function is likely to exceed the benefit a small-cap firm would obtain from it. However, this does not negate the necessity of having an IAF, nor the effect that a lack of one can have on the quality of the financial statements produced.

Competence combined with independence is necessary for effective IAF financial reporting monitoring (Abbott et al., 2016). Regulator 1 and A1 both believed that in-house audit functions have a thorough understanding of the business and its processes. However, they can be easily manipulated and swayed by management, resulting in the function potentially being inefficient. This is consistent with Cohen et al. (2004). An IAF which consists merely of the finance team may compromise its effectiveness, as their independence can be negatively affected as they would be reviewing their own processes. They may also be less likely to be fully competent internal auditors, as the finance team members are unlikely to have internal auditing as their designated qualification. The potential lack of competence decreases the ability to identify issues (such as financial reporting misstatements). The potential lack of independence decreases the likelihood of those issues being appropriately reported and rectified if identified. This could negatively affect the quality of the financial statements produced.

As the companies’ market cap begins to increase from small-cap to the mid-cap range, they are more likely to have outsourced internal audits. They tend to be outsourced because again, the cost of employing 2-3 internal auditors throughout the year often cannot be justified for the size of their business, but they are usually large enough to warrant an outsourced internal audit and are more likely to have the financial resources to do so.

An outsourced internal audit tends to provide an independent view of the business. They are usually detached from the business and often cannot be as easily manipulated as in-house auditors – potentially providing a more effective and objective internal audit. The increased independence may result in a greater likelihood of deterrence and detection of fraud. They are more likely to be competent in performing IAF procedures, as internal auditing would be their designated role and they are likely to have qualifications and experience in this area. This would result in both components of the IAF being present (competence and independence) which could provide a more effective internal audit, than that of an unsophisticated in-house IAF. This is consistent with Abbott et al. (2016). However, since they are outsourced, their knowledge of the business may not be as in depth as that of an in-house function, which could hinder their ability to detect fraud and various other issues. Although, as mid-cap sized firms are smaller in magnitude, it may not be challenging for outsourced IAFs to gain the necessary understanding of the firm's operations. Consequently, mid-cap firms are likely to have adequate IAFs, which could positively affect their financial reporting quality.

> "If you've got an internal group of people and they see something going wrong, there only course of redress would be to act as a whistle blower and then it depends who actually gets on the other end of the whistle blower line… Outsourced internal audits are more independent, but you don't necessarily have people who have knowledge of the organisation and can contract what's happening overtime" R1.

Large-cap entities tend to have sufficient financial resources to justify employing permanent employees for an in-house internal audit function. As a result, large-cap firms often have sophisticated IAFs. Regulator 1 and A1 both believed that sophisticated in-house IAFs, that are comprised of in-house skilled internal auditors, have a thorough understanding of the business and its processes. This will improve the quality of the IAF. Sophisticated, in-housed IAF's tend to possess competence combined with an in-depth understanding of the activities they are auditing, allowing potential issues to be identified more frequently. Despite there being a higher possibility of issues being identified, there is a lower possibility of them being reported appropriately, as in-house IAFs may lack independence. These opinions are consistent with Cohen et al. (2004).

Some of the primary roles of the internal audit are to ensure financial accountability, transparency, examine the financial statements and ensure financial reporting controls are operating effectively (Shamsuddin et al., 2014). Good internal audits have been found to improve the accuracy of the financial statements and consequently their credibility (Ekuitas, 2018). If small-cap firms lack the necessary competence of the IAF, there is a decreased ability to identify control deficiencies. With less independence, the transparency of the financial statements may decrease too. If accountability and transparency improve the quality of the financial statements by making them more credible, the IAF of small-cap firms may be negatively impacting this attribute of the financial statements.

4.2.7. Sophistication of the audit committee at small- and mid-cap firms

From A1 and R1's perspective, there is a difference between the audit committees of large-cap firms and those of small- and mid-cap firms. Audit committees of large-cap firms tend to have chairs who are very experienced and sit on numerous company boards in various industries. The board representation in terms of demographics, skillsets and age is often more diverse in large-cap firms. As large-cap firms generally have access to more resources, they are likely to be able to allocate more resources to obtaining a highly experienced and qualified audit committee. Small-cap and mid-cap firms often believe that it is unnecessary to have a highly qualified finance team. Similarly, they may share the same sentiment on the need to have a highly qualified audit committee. As a result, they often appear to have audit committee chairs who are less experienced, and only sit on a few or no other company boards. This can lead to a difference in attitude and performance of the audit committees amongst the different sized market caps.

> "The large companies, pride themselves in having an audit chair that is well versed, has got experience in various industries. Whereas the smaller firms are happy if they have an audit committee chair that mainly serves on one other listed company. Or in some cases, don't serve on any other listed entities. So no, there is difference" A1.

Auditor 1 explained that audit committees of smaller firms tend to be less accommodating to the external auditors and less trusting of them. They tend to have less experience and are less knowledgeable about IFRS, like the management in these firms. The audit committees on large-listed firms tend to have a well-rounded view and experience on various industries that result in them being more open-minded and knowledgeable on IFRS.

Audit committees are required to approve and oversee the quality of the external audit. Audit committees of smaller firms may be more critical of the external auditors and less willing to agree to the changes and suggestions related to the financial statements made by external auditors. This can result in lower quality audits being performed, as external auditors may be less willing to suggest changes to improve the quality of the financial statements when they believe that these changes are likely to be rejected. This would be similar to the sentiment A1 shared on small- and mid-cap firms – as she was less inclined to provide value-add to these clients as they often do not appreciate nor listen to it.

> “I get lashed more by the smaller audit committee members” A1.

From the small-cap firms interviewed, the audit committees appeared to be minimally present in the financial reporting process – corroborating with the opinions of A1 and R1. The audit committees appear to meet only their regulatory requirements but not overextend themselves in the financial reporting process.

> “Hmmm [large pause and hesitation].
> Look, at year end I suppose they gave their valuable inputs but other than that there's nothing else. I mean we've got; you know, we are always free to phone them or contact them or whatever but there haven’t been any issues” P7.

In contrast, the preparers of mid-cap companies explained that their audit committees have a high level of financial expertise and experience and are heavily involved in overseeing the financial reporting process.

> “We're very fortunate we've got a very strong audit and risk committee. Audit and risk are combined headed by a very strong, and technically strong chairman who gives us a hard time but very, very good, very supportive, thorough. He takes the role extremely seriously and actually provides support to the finance team – he does review the financials, does give input clearly, not just rubberstamping. It creates a lot of work and I've got to be on my toes, but I like it. Then another member on the on the audit committee, ex-audit partner, also provides lot of input, technical input, he even casts the financials” P4.

The opinions of the auditors interviewed corroborate the preparers’ views on the audit committees at small-cap firms but not that on mid-cap firms. This may indicate that only small-cap firms are often prone to less effective and diligent audit committees. The audit committee seem to be more involved in the financial reporting process and questioned the finance team more as the firm size increased. This may suggest that there is a positive correlation between firm size and the quality of the audit committee, consistent with Ettredge et al. (2011) and Bédard and Gendron (2010). If small-cap firms' audit committees are often comprised of members who are less willing to be involved in the financial reporting process, have less power and lower financial sophistication, the audit committee's ability to ensure high-quality reporting will diminish. High-quality reporting disclosures would likely also decrease, as the audit committees comprise of less financial expertise.

There may be a benefit for small- and mid-cap firms possessing audit committee members who hold less directorships. The quality of the audit committee may improve if the members are not under excessive demand and have more time available to oversee the financial reporting process. Ghafran (2013) found that the number of directorships held by members of the audit committee was negatively related to financial reporting quality. Irrespective of this, if small- and mid-cap firms' audit committee members are not as committed, as A1 and R1 expressed concerns over and identified in the small-cap firms interviewed, they may not use their available time effectively in fulfilling or exceeding their duties, negating the benefit of fewer directorships.

Cost appears to be the primary reason for smaller listed firms not obtaining high-quality, experienced audit committee members. Audit committees need to be compensated sufficiently in exchange for the risk they absorb and the skills and experience they provide. Large-cap firms are more attractive in terms of financial benefits and prestige. This could make it difficult for small- and mid-cap firms to attract talented personnel for their audit committee. All small- and mid-cap firm preparers interviewed explained that they experienced very low audit committee member turnovers. Since the preparers of small- and mid-cap firms are generally less experienced and motivated in the financial reporting process, they may not be demanding better quality audit committee members.

> "The fees are very different. The motivation to take on the risk as a director in a small cap firm has to be something other than money" R1.

If the audit committees are less experienced, and less willing to be involved in overseeing the financial reporting process, there is potential for a poorer relationship to exist between the audit committee and the IAF. This may cause a decline in corporate governance capabilities of both functions. The IAF at small-cap firms, as previously discussed, are typically comprised of the finance team. This removes IAF's ability to become an agent of the audit committee and the ability of the audit committee to oversee the IAF, which can diminish the IAF's independence further.

4.3. Consequences of the corporate governance structure of small- and mid-cap firms

All aspects of the corporate governance structure are usually affected by a primary challenge which small- and mid-cap firms face – their limited access to resources. The limited access they often have to resources, in particular to finance, can limit their access to various other resources, and may create further challenges in producing high-quality financial statements. This would negatively affect their ability to obtain the best managerial capabilities, accounting software and human capital across their finance team, internal audit function and audit committee in line with Yoshino and Taghizadeh Hesary (2016). The finance team has the ability to directly affect the quality of the financial statements. The IAF often being unsophisticated in small-cap firms and the audit committees typically lacking highly experienced members, may further adversely affect the quality of the financial statements. This is because these functions oversee the finance team and its performance, in accordance to the 6-legged stool developed by Rezaee (2003). The external audit is often negatively affected by these internal roles being compromised, as usually less time is available to provide ancillary services of the audit to the client. However, this does not mean that the external audit is of a lower quality, but rather the ancillary services provided may be less.

Lower quality financial statements could be produced by small- and mid-cap firms because of limited resources. The finance team, IAF, audit committee and external audit fall within the corporate governance mosaic produced by Cohen et al. (2004) as seen under Figure 2. The results are supportive of Cohen et al. (2004), who found that financial reporting quality is associated with the strength of the corporate governance within the firm and is affected by the firm's ability to attract and retain quality human resources, IT capabilities and availability to financial resources. The limitation to resources also appears to be connected to the size of the firm. This possible positive association between the quality of financial statements with firm size would align with the positive association found by Lee and Yeo (2016) between the quality of integrated reports and firm size. It would also be consistent with Buitendag et al. (2017) who found that since larger entities have greater access to resources to allocate to collecting and analysing information, they often produce higher quality financial reports.

"I found the quality to be better at the larger entities" TA1.

However, the capabilities of these functions need to be considered in relation to the magnitude of the small- and mid-cap firms. These firms are inherently smaller in size, with less diverse operations, and therefore often have less complexity. Their size and magnitude may not require highly experienced and talented staff to effectively perform their functions. Small- and mid-cap firms appear to have low staff turnovers in both their finance teams and audit committees, as well as smaller hierarchies within their management. Their longer tenures and direct access to information are likely to provide them with thorough understandings of their business and operations, and significant experience in their respective environments. This is likely to be sufficient for them to successfully perform their duties and produce IFRS financial statements. However, as there may be less reputational pressure on small- and mid-cap companies with regards to their financial statements and fewer investors, they are likely to have less public accountability. Their users typically do not use the financial statements as their primary source of information on the firm. As a result, small- and mid-cap firms may have less motivation to use financial reporting to obtain a sense of trust and credibility. Preparers, although often experienced in their roles, may not typically do not go beyond complying with the basic minimum in IFRS because there is a less incentive. The preparation is approached as a regulatory requirement, and not a meaningful mechanism for communication to their users. As the users of these financial statements are usually not diligently reviewing these financial statements, the lower quality tends to go unnoticed, and they often do not demand it to be different. Consequently, the quality of the corporate governance structure at the firms will often remain unchanged.

"So, [laughter] we just ignore it and only disclose what we have to" P4.

5. Conclusions and recommendations

Small- and mid-cap firms are smaller in magnitude than their large-cap counterparts. Their operations are often smaller in capacity and are usually less dispersed geographically. This typically translates into lower absolute revenues and net assets resulting in tighter budgets and smaller cash reserves. In comparison to their larger counterparts, it was found that small- and mid-cap firms usually have challenges accessing: (1) the latest information technology, and (2) sourcing the highest quality human capital in their financial team, IAF and audit committee. These

2 challenges can lead to a lack of expertise and sophistication. Although small and mid-cap firms do still receive acceptable audits, they are typically more reliant on their external audit function. The inefficiencies are often caused by this tend to decrease the time available to provide ancillary services to the external audit.

However, small- and mid-cap firms' primary challenges to (1) obtain the latest technology and (2) attract and retain the best minds in the industry may be mitigated by the reduced complexity and magnitude of their operations. As they are smaller firms, there are often fewer levels of management. This usually results in the finance staff being more involved in the decisions of the company. Often this led finance teams at small- and mid-cap firms to have higher levels of self-perceived job satisfied and generally felt as though they were happier in their positions at the company. This typically results in their tenure at the firm to be longer. With lower staff turnover, it is likely that they have a significant amount of experience within the firm, its operations and their specific roles. The lower hierarchy that often exists at these firms also allows them to have direct access to information, decreasing communication and information costs. These factors appear to assist with their execution of their duties as the long tenure improves their decision making and managing of the business.

High-quality financial statements typically involve tailoring the financial statements to be specific to the firm in terms of relevance, materiality and how they are presented to users. A low turnover in the finance team is likely enabling small- and mid-cap preparers to have the knowledge and understanding of the business for high-quality financial statements to be produced – irrespective of the fact that they face challenges and are not always able to attract and retain the most talented staff within their industry nor employ teams of highly skilled accountants mainly focused on the preparation of financial statements.

Results indicate that the financial statements are not usually the users' primary source of information when making decisions related to the firm. The financial statements are audited which enhances their credibility and provides a base-line sense of security to the users, and at least, the accounts are in order and comply with IFRS, laws and regulations. The users of small- and mid-cap firms typically only require the financial statements to corroborate the numbers found in the ratios and performance metrics that they are using to evaluate the performance of the firm. This causes agency costs to decrease for the users of small- and mid-cap firms' financial statements, as they tend to use means that are quicker and easier to use. As per stakeholder theory, this seems to decrease the motivation preparers of small- and mid-cap firms have to prepare the highest-quality financial statements possible. However, no users of small- and mid-cap firms were interviewed in the sample and the research does not intend to make generalisations over these users. Further research would have to be performed to provide clarity from the users' perspective of small- and mid-cap firms to ascertain if they do in fact rely on financial statements less.

The perceived decreased interest in their financial statements is likely to make it more difficult to justify the trade-off between focusing limited time and resources into improving the quality of financial statements and running the business. For example, the time and resources that required to (1) determine the most relevant issues each year and then (2) re-structure the set of financial statements so that the most material and relevant items are presented first appears to exceed the perceived benefits to users. Although this seems like a minor exercise, re-ordering financial statements has significant editorial knock-on effects with note numbers, references and layout all requiring adjustments. There appears to be a negative feedback loop where the perceived increased complexity, reduced relevance and availability of other information sources has reduced reliance on AFS (Pandya et al., 2021). This, in turn, results in less effort to ensure the financial statements are relevant, useful and understandable by the users. This was indicative of the reputation effect.

As small- and mid-cap firms are usually not dependent on financial statements to enhance their reputation, there is often less desire to make them high-quality, when the extra effort is perceived as usually going unnoticed. The small- and mid-cap firms interviewed were all dependent on their users for the provision of finance. However, since the users tended to not diligently analyse the financial statements, and per the resource dependency theory, there is an absence of the need to produce high-quality financial statements according to Figure 1. When the small- and mid-cap firms complied with the absence of this need, lower quality financial statements appeared to be produced – indicating Figure 1 to be accurate. The reduced effort by prepares reinforces the users' original perceptions, and the cycle continues. As a result, the financial statements produced by small- and mid-cap firms typically do not go beyond merely complying with IFRS.

The preparation of AFS is usually approached as a regulatory requirement and not necessarily a meaningful mechanism for communication with their users. Few or no techniques which would improve quality, such as adjusting boiler-plate templates, providing items in order of materiality and providing clear links between different, but relevant, notes, statements and documents were used by the preparers interviewed. Instead, small- and mid-cap firms, as a result, can be producing financial statements that comply with IFRS, but are not adapting their financial statements with the aim to achieve high-quality and improve overall understandability of the business. If the users of these financial statements are usually not diligently reviewing these financial statements, the lower quality would likely go unnoticed.

There was one notable exception to most of this study's findings. A mid-cap, bordering on large-cap, financial services company did show a strong inclination towards preparing high-quality financials, attracting and retaining expert personnel and investing in the latest technology. This company engages more directly with general consumers and is a highly regulated firm. These 3 factors may be causing it to be an outlier (van Zijl et al., 2017). More research is required to unpack this exception.

In summary, the following was found for the challenges identified in the Literature review:

Table 4: Summary of the challenges facing small- and mid-cap firms in producing high-quality financial statements identified in the research

Challenge identified in Literature review	**Present in research**
Limited financial resources restrict the size of the finance team at small- and mid-cap firms	Smaller finance teams were found at small- and mid-cap firms, however, it is unlikely that the size of their firms justifies having the same sized finance teams as their large-cap counterparts. This would not be seen as a challenge.
Limited financial resources restrict the ability of small- and mid-cap firms from attracting and retaining talented finance staff	Small- and mid-cap firms appeared to have limited ability in obtaining the most talented and qualified financial expertise. Although, they do not appear to struggle in retaining their staff. Longer tenures combined with less complexity may mitigate this challenge.
Limited financial resources may lead to unsophisticated I.T. systems.	Across all interviews it appeared that small- and mid-cap firms have unsophisticated I.T. systems. This is a challenge.

Limited financial resources may affect the sophistication of small- and mid-cap firms' IAFs	Small-cap firms interviewed had internal unsophisticated internal audit functions. Mid-cap firms interviewed had sophisticated outsourced IAFs. This would appear to be only be a challenge for small-cap firms.
Quality received from external audit is affected by: • Whether a firm is audited by a Big 4 or non-Big 4 auditor; • If audited by a Big 4 auditor, whether less resources are allocated to small- and mid-cap clients; and • If the quality of work produced by small- and mid-cap clients affects the value-add provided from the external audit.	Quality external audits are found to be received irrespective of the size of the audit firm. Less resources were found to be allocated to small- and mid-cap firms in comparison to large-cap firms. This can be justified as small- and mid-cap firms' operations tend to be less complex and are smaller in size. The value-add provided may be less due to inefficiencies that often occur during the audits of small- and mid-cap firms. This would impact the ability to produce high-quality financial statements produced and would appear to be a challenge.
Audit committee members may have less experience and diversity, decreasing the quality of the audit committee's oversight on the financial reporting policy.	The audit committees appeared to be indifferent at mid-cap firms, but it appeared that audit committees were less involved in the financial reporting process at the small-cap firm interviewed. This would present as a challenge for small-cap firms.

This research did not explore the differences in challenges faced by small- and mid-cap firms by industry. Such a study would be useful if explored across the different industries within the small- and mid-cap JSE listed firms. Some industries, specifically the finance and banking industry, are significantly more regulated. The higher regulation may have an effect on the quality of the financial statements produced. There may be an association that the higher the regulation, the higher the quality of the financial statements, irrespective of whether their users are utilising their financial statements as they are forced to do so by law and regulation. Other industries may be prone to attract personnel with specific traits, which can result in higher competition, and therefore motivate finance employees to perform at their highest – positively affecting the quality of financial statements.

The research did not focus on interviewing preparers of large-cap firms listed on the JSE. Confidence in the results may be improved if future research focused on contrasting the experiences of preparers at small- and mid-cap firms to the experiences of those at large-cap firms. This will also corroborate or dispute some of the claims made by the interviewees of this study with regards to (1) involvement in decision making, (2) job-satisfaction and (3) staff turnover.

Finally, this research was specific to JSE listed firms in South Africa. Further research can be done to determine if the challenges small- and mid-cap firms face when producing high-quality financial reports are experienced in numerous other countries.

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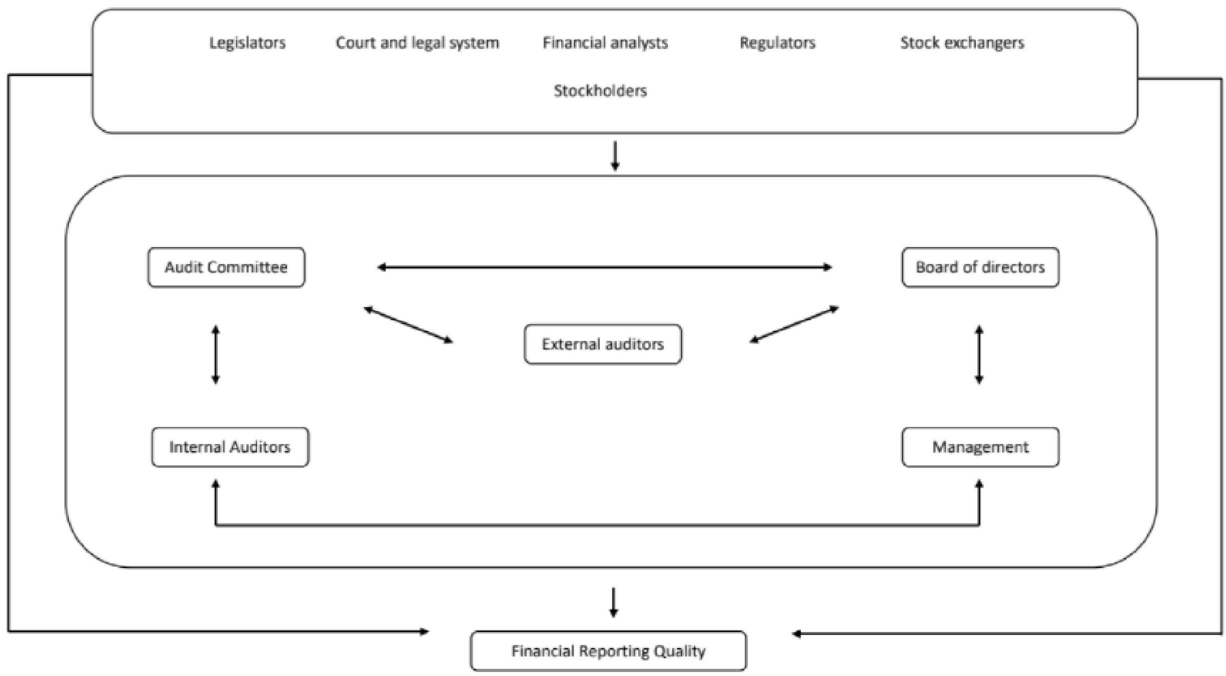
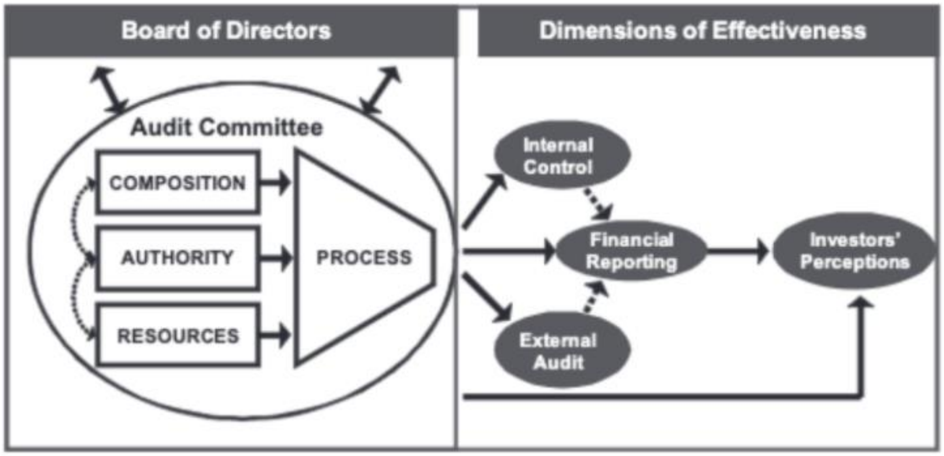
Appendixes

Appendix 1

Figure 2 : *Corporate governance mosaic (Cohen et al., 2004).*



Appendix 2

***Figure 3*: *Audit committees and dimensions of effectiveness (Bédard and Gendron, 2010)*.**


Appendix 3

INFORMATION SHEET FOR PARTICIPANTS

Ethics clearance number:

Title: Financial reporting quality: An exploratory study of small- and mid-cap entities

Dear Sir/Madam

My name is Leigh Brookes and I am a masters student in the School of Accountancy at Wits University in Johannesburg. As part of my studies I have to undertake a research project. I am evaluating what challenges small- and mid-cap JSE listed firms are facing in terms of producing high-quality financial reporting. We would like to invite you to participate in this research project. You should only participate if you want to; choosing not to take part will not disadvantage you in any way. Before you decide whether you want to take part, it is important for you to understand why the research is being done and what your participation will involve. Please take time to read the following information carefully and discuss it with others if you wish. Ask us if there is anything that is not clear or if you would like more information.

- In this study, we want to investigate the challenges your company may be facing in producing high-quality reports.
- If you agree to participate, a time will be scheduled for an interview that is expected to take 60 to 90 minutes to complete.
- There are no material risks posed by participating. Your identity and place of employment will be kept confidential. No personal information will be collected from you.
- There are no right or wrong responses – this research is only interested in your own experiences and impressions.
- Interviews will be audio recorded, subject to your permission. The interview will be transcribed and kept on file by the researcher but your identity and that of your employer and/or clients will be kept confidential and will not be referred to directly in the final research report.

- You will not receive any compensation for participating in the research. There is no direct benefit from participating or not participating in the research.
- Should you be interested, a copy of the final report will be available to you on request.

It is up to you to decide whether to take part or not. If you decide to take part, you are still free to withdraw at any time and without giving a reason. In addition to withdrawing yourself from the study, you may also withdraw any data/information you have already provided up until it is transcribed for use in the final report.

If this study has harmed or offended you in any way, you can contact the University Human Research Ethics Committee (non-medical), telephone +27(0)11 717 1408, email hrec-medical.research@wits.ac.za/ Shaun.Schoeman@wits.ac.za. If you require further advice and/or information, the researchers can contacted using the details below:

Details	Researcher 1	Researcher 1	Researcher 2
Name	Leigh Brookes	Wayne van Zijl	Warren Maroun
Contact number	+27 84 402 4073	+27(0)11 717 8227	+27(0)11 717 8245
Email address	Leigh.Brookes@wits.ac.za	Wayne.VanZijl@wits.ac.za	Warren.Maroun@wits.ac.za

Yours sincerely

Leigh

CONSENT FORM FOR PARTICIPANTS IN RESEARCH STUDIES

Please complete this form after you have read the Information Sheet and/or listened to an explanation about the research.

Title of Study: **Financial reporting quality: An exploratory study of small- and mid-cap entities**

Ethics Committee: SOA-2020-07-17

Details	Please tick or initial
I agree that my participation will remain anonymous	
I agree that the researcher may use anonymous quotes	
I understand that if I decide at any time during the research that I no longer wish to participate in this project, I can notify the researcher involved and withdraw from it immediately without giving any reason. Furthermore, I understand that I will be able to withdraw my data up to the point of submission of my responses.	
I understand that the information I have submitted will be published in a thesis and/or publication and that I can request a copy of the final article.	
I understand that my personal information will not be collected. My identity and that of my employer and/or clients will be kept confidential and will not be referred to directly in the final report.	
I agree that the information I provide may be used anonymously in other research projects	
I consent to my interview being recorded/to may data being used in the research/my questionnaire being included in the final results.	

Participant's Statement:

I ____

Agree that the research project named above has been explained to me to my satisfaction and I agree to take part in the study. I have read both the notes written above and the Information Sheet about the project, and understand what the research study involves.

Signed   Date

__________________________   ______________________________

Appendix 4

SCHOOL OF ACCOUNTANCY

Interview Agenda

- Perception of own quality of financial reports produced by firm.
- Discussion over dependency or lack of dependency on equity or debt financing and the relationship with these stakeholders.
- Discussion over internal and external audit.
- Discussion of challenges affecting quality of financial reports.

Appendix 5

Table 5: Classification of firms listed on the JSE by market capitalization	
Small-cap firm	Market capitalization below R1 Billion
Mid-cap firm	Market capitalization between R1 Billion and R10 Billion
Large-cap firm	Market capitalization exceeding R10 Billion