

Nordic Journal of Business

Vol. 75, No. 1
(Spring 2026)




NJB

Nordic Journal of Business

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Editor's Letter

This issue of the *Nordic Journal of Business* features two peer-reviewed articles. In the first article, Jaana Tähtinen, Anna-Mari Simunaniemi, and Riikka Franzén examine how micro-entrepreneurs, public authorities, and scholars understand corporate social responsibility (CSR), and propose a contextual conceptualization of micro-enterprise CSR. The second article by Irina Alexeyeva, Peter Frii, Ann-Sofie Henrikson, Annina H. Persson, Oscar Stålnacke, and Stefan Sundgren reviews the theoretical and empirical literature on mandatory auditing requirements for small private firms.

I hope you enjoy reading the interesting articles included in this issue of the *Nordic Journal of Business*.

Sami Vähämaa

Editor

Nordic Journal of Business

Understandings of CSR for Transdisciplinary Research with Micro-Enterprises*

Jaana Tähtinen, Anna-Mari Simunaniemi and Riikka Franzén

Abstract

Global sustainability challenges can be addressed through transdisciplinary research, where scholars from different disciplines collaborate with non-academics, including micro-enterprises and public authorities. A fundamental requirement for successful collaboration is that each participant understands the language of others. However, that is not often the case, as the key concepts are rarely defined or contextualized. The results of the study are two-fold. This study elicits and contrasts micro-entrepreneurs', public authorities', and scholars' understandings of corporate social responsibility (CSR) and suggests a contextual conceptualization of micro-enterprise CSR. Additionally, the modification of the conceptual analysis method (CAM) offers a tool that can enhance communication in transdisciplinary research.

Keywords:

corporate social responsibility, micro-enterprise, collaborative research, theory elaboration, modified conceptual analysis method (CAM)

Jaana Tähtinen is a Professor Emerita of Marketing at the University of Turku, Finland.

Anna-Mari Simunaniemi is a Principal Researcher at JAMK University of Applied Sciences and a Visiting Senior Fellow at the Kerttu Saalasti Institute of the University of Oulu, Finland.

Riikka Franzén is a Researcher at Turku University of Applied Sciences, Finland.

*We thank the micro-entrepreneurs who participated in this study, as well as Essi Saru and Anu Ikonen-Kullberg from University of Turku for their comments on an earlier version of this study. Tanja Lepistö from the University of Turku and Jaana Jeminen and Sari Liikala from University of Oulu contributed to data collection. The first author thanks the Foundation for Economic Education for partial funding of this study.

1 Introduction

Resolving pressing global problems requires transdisciplinary dialogue and research collaboration between industry and academia (Kieser & Liener, 2012). Scholars from different disciplines need to collaborate with stakeholders, lay communities, or non-academics, such as public authorities and the owner-managers of micro- and small companies (e.g., Kieser & Leiner, 2012; Mauser et al., 2013) to co-produce relevant information (Mobjörk, 2010). A fundamental requirement for successful transdisciplinary research is that each participant understands the language of others.

Although scholars “do things with words” (Nilsen 2005, 131), they do not always share a language, and non-academics seldom share a language with scholars. The concepts used in research are rarely defined or contextualized (Brown et al., 2022; Lambert & Newman, 2023; MacKenzie, 2003), nor self-evident to non-academics. Hence, concepts are unable to perform their role of organizing and communicating ideas clearly (Bacharach, 1989). Although scholars have attempted to clarify the concepts of corporate social responsibility (CSR) and social sustainability, the conceptual landscape remains largely unclear. The two umbrella concepts have become even more abstract (Colantonio, 2009; Homer & Gill, 2022; Matten & Crane, 2005) and have converged despite their different origins (Bansal & Song, 2017)¹. The situation hinders the development of theoretical understanding and practical responsibility work (Lindgreen and Swaen, 2009).

Some have called for “a common reference point” (Okoye, 2009, p. 623) and a widely accepted definition (Frynas & Stephens, 2015; Godfrey & Hatch, 2007) of each concept with sharp boundaries (Bansal & Song, 2017). The complexity involved is encapsulated in the description of CSR as a tortured concept (Godfrey & Hatch, 2007) that must be flexible (Mitnick et al., 2021; Okoye, 2009; van Marrewijk, 2003). Moreover, CSR research incorporates contrasting economic and moral perspectives (Godfrey & Hatch, 2007). The relationship between business ethics and CSR remains unclear (Enderle, 2010), and several CSR-related constructs have been proposed (De Bakker et al., 2005). Consequently, Mitnick et al. (2021) called for systematic conceptual analysis to advance the field. Nevertheless, citation rates of studies conceptualizing CSR are declining (Frerichs & Teichert, 2023) even though understanding the language used in different contexts would aid effective research communication and spur advancements in the study and implementation of CSR. For example, to date, EU law includes 1766 instruments (EUR-Lex, Access to European Union law) on CSR, all of which legislators and management strategists might need to be cognizant of.

The use of and meaning ascribed to the term CSR by micro-entrepreneurs remains a neglected research area (Lindgreen & Swaen, 2009; Koleva & Meadows, 2025; Weller, 2020). Given that 99.8% of EU businesses in 2023 were micro or small companies, which employed almost two-thirds of the active population (Eurostat, 2025), CSR in the micro-enterprise² context influences a significant portion of society. Moreover, micro-enterprises face CSR demands. Although the European Commission’s February 2025 Omnibus raised applicability thresholds of the Corporate Sustainability Reporting Directive (EU) 2022/2464 (CSRD), the EU Taxonomy Regulation (Regulation (EU) 2020/852) targets increasing investment in sustainable activities.

¹ For a discussion on the relationship between the concepts of CSR and social responsibility see e.g. Ashrafi et al. (2018).

² European Commission (2005) definition of a micro-enterprise: fewer than 10 employees and an annual turnover or balance sheet below €2 million.

Thus, the EU regulation indirectly affects micro-enterprises through financing conditions and supply-chain expectations, as investors and large partners increasingly demand sustainability data from suppliers, particularly related to public procurement. Hence, regulatory burdens remain minimal, whereas market-driven pressures may increase.

The ongoing calls for more research on CSR in small companies (Chiesa & Pszychodzen, 2020; Homer & Gill, 2022), small business CSR (SBSR) (Soundararajan et al., 2018), and the micro-level (Aguinis & Glavas, 2012; Frynas & Stephens, 2015) underscore the importance of eliciting conceptual differences to avoid misguided knowledge (Godfrey & Hatch, 2007). Scholars collaborating with non-academics should not impose their conceptualizations on others (Kieser & Leiner, 2012). Instead, the parties should discuss and reveal how all involved understand the phenomenon in their contexts (Brown et al., 2022). Current solutions to lower the communication barriers suggest cultivating practitioners (McCabe et al., 2023) and utilizing knowledge brokers, or 'translators,' who have worked in both worlds (Grafström et al., 2023). Sharing a language, for example, through long-term engagement (Van de Ven, 2018), is considered a key factor in successful industry-academia collaboration (Bjerregaard, 2010; Di Benedetto et al., 2019). However, when initiating transdisciplinary research, a quicker solution is needed to address the lack of shared vocabulary (Mausser et al., 2013).

This study sheds light on how micro-entrepreneurs, public authorities, and scholars comprehend corporate social responsibility (CSR). The results elicit and contrast the three parties' understandings of corporate social responsibility (CSR) as conceptual maps and suggest a contextual conceptualization of micro-enterprise CSR. In doing so, this study contributes to the elaboration of CSR theory and answers the call for CSR conceptualization by Koleva and Meadows (2025).

The method for contrasting the understandings of CSR is a modified conceptual analysis method (CAM). The original CAM (Tähtinen and Havila, 2019; Tähtinen & Suomi, 2022) is modified in this study to discover and illustrate the differences in language between and within user groups. The original CAM was developed to clarify a conceptual confusion in an emerging research field, where scholars use multiple concepts to refer to a phenomenon (Tähtinen & Havila, 2019). The original CAM, which focused on scholarly definitions within a discipline, has been used accordingly (Antera, 2021; Rantamäki & Jalonen, 2022; Tähtinen & Suomi, 2022). The modified CAM shows how the understandings of a phenomenon by scholars from different disciplines and non-academics are influenced by the contexts in which they operate. Once the understandings are exposed, visualized, and contrasted, the knowledge helps to avoid conceptual confusion that would otherwise exist between groups and even within them. Scholars can also utilize the results of modified CAM in theory elaboration (Fisher & Aguinis, 2017), refining other key concepts and contrasting them in various contexts.

2 Research Approach

The study employs abductive reasoning (Peirce, 1998), a method also advocated by Fisher and Aguinis (2017) for studies targeting theory elaboration. The methodology decision was driven by the empirical discovery made during a university-led CSR project, where micro-entrepreneurs practicing CSR were uncertain about the 'proper' meaning of CSR and how to describe their company's CSR activity. The discovery prompted us to study the understandings of the different groups that often participate in transdisciplinary projects, including academics, non-academics, and professional authorities who finance the projects.

The study modifies the CAM (Tähtinen & Havila, 2019; Tähtinen & Suomi, 2022) to analyze the different user groups' understanding of the same concept, as the CAM emphasizes the voices of users in their context and how they shape a concept. The CAM was originally developed to elucidate conceptual confusion where scholars employ multiple concepts to refer to a phenomenon (Tähtinen & Havila, 2019). For that purpose, the CAM includes five steps: collecting the scholarly definitions, evaluating the conceptual status of the field, categorizing the meanings and boundaries of the concepts, tracing their theoretical underpinnings, and drawing conceptual maps (Tähtinen & Havila, 2019; Tähtinen & Suomi, 2022). The steps of CAM have been applied in various disciplines, for example, to clarify concepts related to professional competence (Antera, 2021), switching costs (Kim, Byon, & Choi, 2020), and integration (Teräs, 2023).

For this study, we modified the first step of the CAM by adding two data sources. In addition to using the scholarly definitions of CSR as data, we interviewed micro-entrepreneurs and utilized definitions used by public authorities that promote CSR. In addition, we elucidate only a key concept, namely CSR, and skip Step 4; tracing the theoretical underpinnings, which is unnecessary in pragmatic transdisciplinary research. These modifications enable CAM to lay out the differences and similarities in the understandings of different parties, representing different contexts. Thereafter, the parties are in a better position to understand each other in collaboration, whether they decide to align their views temporarily or to embrace the variety discovered. However, theory elaboration can be further advanced by tracing the theoretical roots of scholars' understandings of the concept.

The abductive nature of the study and three user groups of the CSR concept guided the unconventional tripartite structure of this study. The first part presents the views of micro-entrepreneurs, the second the views of public authorities, and the third the scholarly view. Each part begins with a description of the methodology for that section. The paper thus continues with Part One, presenting both the methodology applied in Part One and the results relating to micro-entrepreneurs' understanding of CSR. The two other sections follow the same format. The study concludes by outlining the understandings of CSR among micro-entrepreneurs, researchers, and public authorities, the contextual conceptualization of micro-enterprise CSR, and the steps in the modified CAM.

3 Part One: Micro-entrepreneurs and CSR

3.1 Modified CAM Methodology Applied in Part One

The empirical data for CAM consist of semi-structured interviews (Brinkman, 2014) of 23 micro-entrepreneurs from two Finnish regions, North and South-West Finland, who participated in university-led CSR coaching. The interviews were conducted at the beginning of the coaching and were intended to help customize the coaching; thus, the coaching had not yet influenced the participants' views. The timing of the interviews created a relatively equal position for the informants as they could freely express their understanding without fear of seeming unknowledgeable. This setting resembles transdisciplinary research, where we suggest using the CAM at the start of the project. The informants consented to the use of the data for research purposes.

Table 1. Micro-entrepreneurs as informants

INDUSTRY	OWNER-MANAGER	NUMBER OF EMPLOYEES
Nail and beauty salon	Female	-
Landscaping	Male	-
Social media marketing	Female	-
Advertising agency	Female	-
Accommodation	Female and male	-
Tourism services	Male	-
Tourism services	Female	-
Clothing retailer	Female	-
Management consulting	Male	-
Artistic creation	Female	-
Roastery	Female	1
Restaurant services	Female	1
Clothing retailer	Female	1
Food production	Female	1
Advertising agency	Male	1
Research and development services	Male	3
Upholstery business	Male	4
Food production	Female	4
Social and health services in homes	Female	4
Field sports retailer	Male	5
Technical building services	Male	6
Art-based therapeutic services	Female	9
Bedding manufacturer	Female	8–9

Table 1 illustrates the informants’ various lines of business and showcases the variation in their industry-specific positioning on sustainability management. The interviews explored the entrepreneurs’ perceptions of sustainability, responsibility, and social sustainability, as well as their companies’ social sustainability practices. The audio-recorded interviews were conducted in Finnish, the native language of both interviewers and informants, and lasted between 30 and 90 minutes.

The content analysis (Krippendorff, 2004) of the interviews is based on a data-driven approach. Initially, all content related to CSR was identified from direct responses to the question “What does social responsibility mean to you / your company?” or indirect descriptions of company values and practices through which CSR is implemented within the companies. The following analysis phase identified the interview sections where the entrepreneurs describe their social responsibility-related values, actions, business strategies, and situations.

Finally, we used five attributes along which the interview extracts were categorized. Those categories were formed based on two simultaneous inductive content analyses: analysis of the interview data by two authors and analysis of scholarly definitions from CSR research by a third

author (described in Section 5.1). All authors discussed and cross-checked the evolving categories and the final analysis tables to reach a consensus. Table 2 presents a section of the analysis tables in Excel; similar tables were used in all analyses (Sections 4.1 and 5.1).

Table 2. An example from the analysis tables

RESPONSIBLE ACTOR						STAKEHOLDERS TARGETED				
Firm no	manager	company	employees	customers	suppliers/ dealers	family	the OM	(local) community	citizens/ society	competitors
7	✓		✓	✓	✓	✓		✓	✓	
10	✓	✓		✓	✓			✓	✓	
4	✓	✓	✓	✓				✓		
9		✓	✓		✓					

THE NATURE OF CSR						THE COMPONENTS OF CSR						
Firm no	thinking	attitude	decision, policy	proactive action	reactive action	outcome	social	cultural	economic	ethical	philanthropic	environmental
7	✓	✓	✓	✓			✓			✓		
10		✓	✓	✓			✓	✓				✓
4	✓	✓	✓	✓			✓		✓		✓	
9	✓	✓	✓									

REASON				
Firm no	for the sake of it	obligation	to benefit	risk management
7	✓			
10	✓		✓	
4	✓			
9	✓		✓	

The first attribute describes who is responsible for CSR and is the active actor, the company or the manager. The second shows the targets mentioned in the CSR understandings, to whom the social sustainability activity is targeted. The attribute had the most variety: employees, customers, the entrepreneur, their family, suppliers, competitors, local community, stakeholders, and society at large. The third attribute of CSR understandings describes CSR as doing: thinking, attitude, making decisions / having a policy, proactive action, reactive action, and an outcome. Although the concept is corporate *social* responsibility, the understandings can also include economic, environmental, or cultural components of CSR, or even lack the social component. The final attribute illustrates the reason for conducting CSR and tells us why it is performed. CSR was conducted for the sake of it, because of obligation, to benefit the company, or to manage risks. As can be seen from Table 1, the attribute categories are not exclusionary; for example, an understanding may view both the company and its managers as active actors in CSR. In addition, some attributes may be missing from a definition or description.

3.2 Entrepreneurs' Understanding of CSR

When asked directly how they understood CSR, several micro-entrepreneurs expressed uncertainty about its meaning; some requested examples, while others found it a new concept.

The situation echoes Campopiano, De Massis, and Cassia’s (2012) findings, which indicate that SMEs are often unaware of the concept. However, as the discussion continued, the entrepreneurs described multiple practices within their firm that encapsulated social sustainability work, although they viewed them as routine aspects of conducting business.

The entrepreneurs emphasized that a firm’s responsibility must be genuine, not superficial. Some stressed that responsibility is entwined with all company activity, encompassing the everyday actions and decisions of the entrepreneur and the employees. For some, CSR was value-based, grounded in, and aligned with the entrepreneur’s personal values. Such entrepreneurs thus used their own agent capability in their company (Soundararajan et al., 2018). Nevertheless, others saw CSR as a way of differentiating the firm or building its competitive advantage, as Simunaniemi et al. (2023) suggest. The micro-entrepreneurs saw that the company and the individuals representing it were active contributors to CSR.

The views on the scope of CSR differed: the broadest view encompassed the entire world: “Responsibility is making the world better than it was before the business was established.” [Advertising agency]. For micro-entrepreneurs, the target groups of CSR were specific and multifaceted: customers, employees, their own family, suppliers and subcontractors, business partners, funders, other actors in the industry, and/or in their village, region, or country - even ‘everybody’ (see Figure 1). Some described applying social responsibility to themselves, in that they addressed their own well-being and professional capability.

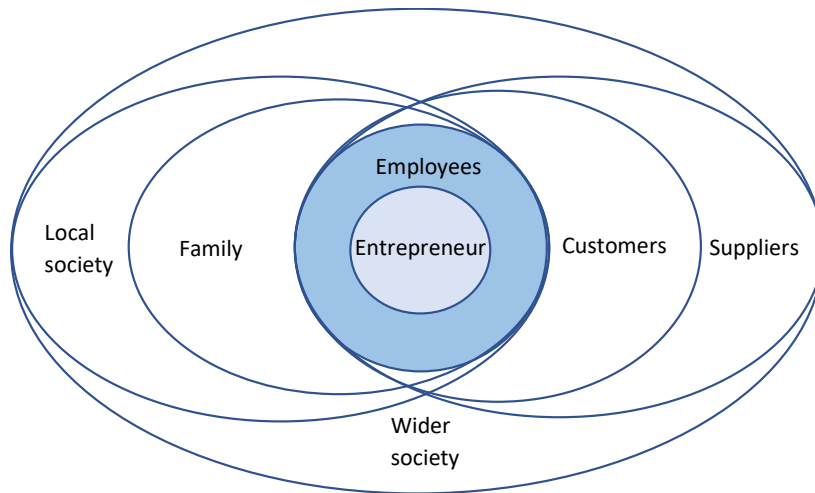


Figure 1. The target groups of micro-entrepreneurs’ CSR

The nature of CSR was described in terms of encompassing integrity and reliability, being as good as one’s word. This view reflects values deeply ingrained in Finnish culture (Helkama & Portman, 2019). Honesty was concretized with example activities in marketing (keeping one’s promises), not hiding anything, being honest with customers about the characteristics of the offering, and in customer service, admitting mistakes when they occur. A strong value base of CSR could result in choosing to serve only those customers that share the same values, “... selecting customers so that you don’t co-operate with or don’t use your expertise to advance ac-

tivities that you don't see as ethical." [Bedding manufacturer]. CSR can also extend beyond satisfying customer expectations or interests and could include providing a positive role model that encourages customers to be socially responsible. That perception supports Soundararajan et al.'s (2018) results, which revealed that small businesses use their social capital innovatively to promote social responsibility wholeheartedly.

Micro-entrepreneurs practiced CSR primarily because they wanted to make the world a better place and/or because it was financially beneficial. Some recognized a tension in balancing their sustainability values and the expectations of certain stakeholders (e.g., financiers and advisers), in the sense that actions must always benefit the business, given that some responsible actions can adversely affect profits.

Some viewed CSR as a standard requirement or a hygiene factor that no longer generates competitive advantage. Some stated that their firm did not communicate a CSR program for fear of customers disputing its claims and being accused of brownwashing. Those micro-entrepreneurs chose to convey their responsible actions implicitly: "To me, it [responsibility] is self-evident. It would feel stupid and a bit hypocritical to write about it." [Upholstery entrepreneur]. This supports Morsing and Spence (2019) theorizing of SMEs' implicit CSR communication.

4 Part Two: Public Authorities' Views on CSR

4.1 Modified CAM Methodology Applied in Part Two

Public authorities are included in the analysis because they are influential advocates of CSR and are often referred to in public funding calls for transdisciplinary research. The data for the CAM, namely the definitions of CSR, were collected from the websites of the following ten authorities and policymakers: Amnesty U.K. (2002); the European Commission (CSR Europe, 2011; Directorate-General for Enterprise, 2003), the European Union (2001), the Government of Canada (2006; 2019), the (India) Companies Act (2013), the International Finance Corporation, a member of the World Bank Group (2014), OECD³ (2018), and the United Nations Industrial Development Organization (UNIDO, 2023). One of the authors analyzed the definitions using the same categories applied to the micro-entrepreneurs' and scholarly data, followed by a discussion with the other two authors to reach consensus.

4.2 Public Authorities' View on CSR

All the definitions examined considered the active parties to be the companies rather than their managers, and the majority referenced society or stakeholders as the groups to be considered. Only the European Commission's Directorate-General for Enterprise's white paper on Responsible Entrepreneurship (2003) specifies target groups, mentioning employees, customers, suppliers, competitors, and the local community.

The definitions exhibit considerably different viewpoints on the nature of CSR. Four bodies describe it in terms of proactive action. Those were the Government of Canada (2006), the Companies Act (2013) of India, the European Commission's Directorate-General for Enterprise (2003), and the International Finance Corporation (2014). There is no agreement on the components of the definition of CSR: three include social, economic, and environmental, three

³ OECD (2018) refers to RBC and views CSR as philanthropy.

comprise social and environmental components, one has social and economic component, and three lack any description. Six state the reasons for CSR, of which two see CSR as a voluntary action performed for its own sake, and three as an obligation to either match or exceed legislative provisions. Hence, the views of public authorities are abstract and varied, and indeed may need updating.

Although not included in the analysis above, we would like to contrast it with the description of sustainable development first expounded by the World Commission on Environment and Development (1987) or the Brundtland Commission. The report (1987, 1.3.27) states that:

[sustainable development] meets the needs of the present without compromising the ability of future generations to meet their own needs. The concept of sustainable development does imply limits - not absolute limits but limitations imposed by the present state of technology and social organization on environmental resources and by the ability of the biosphere to absorb the effects of human activities.sustainable development requires meeting the basic needs of all and extending to all the opportunity to fulfill their aspirations for a better life.

The description sets limitations on growth (in terms of the biosphere and basic needs), expressly encompasses all humans, including future generations, and aims to eliminate poverty. Thus, it is in stark contrast with the abstract understanding of the public authorities studied. The question remains: Shouldn't public authorities be the ones to view CSR as a vehicle to advance sustainable development?

5 Part three: Scholarly Understanding of CSR

5.1 Modified CAM Methodology Applied in Part Three

We modified the CAM to elicit the key attributes of the concepts used in CSR research. The modification of the CAM skips a systematic database search of the literature to collect data because several existing reviews offer suitable data (93 definitions of CSR). Accordingly, our analysis relies on the following studies that either list existing CSR definitions or review recent use of the CSR concept: Carroll (1999, 2021), Cronin (2022), Dahlsrud (2008), Freeman and Hasnaoui (2011), Rahman (2011), and Sarkar and Searcy (2016). However, none of those articles are based on analysis like that conducted in the current study. Reviews agree on there being no single accepted definition of the CSR concept (Aguinis & Glavas, 2012, 2019; Frynas & Yamahaki, 2016; Homer & Gill, 2022). In addition to the numerous definitions of CSR, definitions of small business social responsibility (SBSR) have emerged. Although developed to reflect the SME context, they are used in some research (e.g., Lepoutre & Heene, 2006; Soundararajan et al., 2018) and ignored in others (e.g., Oduro et al., 2024; Spence, 2016), which increases the conceptual variety. No definition of micro-company social responsibility was found.

As discussed earlier, the meanings and boundaries of the 93 definitions and descriptions of CSR were categorized following an inductive analysis. The categories were the same as in the previous two analyses: the actor(s) involved in CSR, the targets or stakeholders considered, the nature of CSR, why the actors practice CSR, and what components are included. The last category refers to CSR's economic, environmental, social, cultural, philanthropic, and ethical components. Although inductive, the categories reflect Whetten's (1989) theory development

building blocks: What (the components), How (the nature), Why (the reasons), Who (the actors), and Where (the stakeholders), only excluding When.

6.2 The scholarly view of CSR

The 93 definitions derive from research spanning nearly a century, from 1938 to 2022. Our data confirm the earlier reviews (Aguinis & Glavas, 2012, 2019; Frynas & Yamahaki, 2016; Homer & Gill, 2022) that the field is affected by polysemy; a single concept is defined in multiple ways. Accordingly, there is potential for conceptual confusion. Over the years, several definitions have been applied, and while some share attributes, no single stream of development toward a unified definition(s) is discernible.

We examined *who* undertakes CSR activity according to the 93 scholarly definitions and descriptions. A majority (64 %) of those CSR definitions only place responsibility at the company level. Surprisingly, only a few definitions (16 %) consider individual managers to be active parties in CSR, either solely or in addition to the company. Moreover, most of those definitions that place the responsibility solely on managers are early examples (e.g., Barnard, 1938; Davis, 1960; Frederick, 1960), with only Elhauge (2005) and Basu and Palazzo (2008) being contemporary. For example, Davis (1960) uses “businessmen” and Basu and Palazzo (2008) use “managers”. A minority of the definitions (5 %) provided between 1967 and 2001 name managers and the company as active actors. The remainder do not specify any actor, as is the case in the following definition applied in Panapanaan et al. (2003), “CSR is about doing business sustainably and ethically as well as treating or addressing stakeholders’ concerns responsibly.”. Companies represented as collections of several managers or owner-managers (as is common in micro-companies) are not mentioned.

Looking at the *stakeholders targeted*, almost half of the definitions consider society as the target of CSR. However, some studies also specify other target groups, such as Jones (1980, 59–60):

Corporate social responsibility is the notion that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law and union contract. Two facets of this definition are critical. First, the obligation must be voluntarily adopted; behavior influenced by the coercive forces of law or union contract is not voluntary. Second, the obligation is a broad one, extending beyond the traditional duty to shareholders to other societal groups such as customers, employees, suppliers, and neighboring communities.

Figure 2 shows that the second most-mentioned target group, stakeholders (20 %), is also broad and appears in later definitions and descriptions. Definitions focused on stakeholders seldom include any other target groups. Only Hawker and Jackson (2001) and Hopkins (2003) refer to employees / internal stakeholders, and Campbell (2007, 951) lists several groups:

I view corporations as acting in socially responsible ways if they do two things. First, they must not knowingly do anything that could harm their stakeholders — notably, their investors, employees, customers, suppliers, or the local community within which they operate. Second, if corporations do cause harm to their stakeholders, they must then rectify it whenever the harm is discovered and brought to their attention.

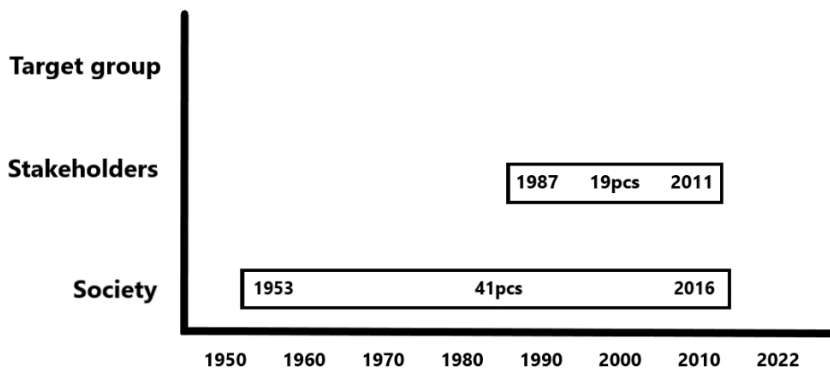


Figure 2. A shift from society to stakeholders as target groups in CSR definitions

Around 65 % of definitions focus on two broad target groups: society and stakeholders. Hence, the target groups or groups to consider in CSR are mostly described at quite an abstract and general level. Scholars might aim to provide concise definitions with broad coverage, suitable for use in any context. The third-placed target group is employees (17%). Only a few definitions specify entrepreneurs, citizens, the government, shareholders, and future generations as target groups.

The third attribute analyzed was the *nature* of CSR activity, which was categorized into the following six categories: thinking, attitude, decisions or policy, proactive action, reactive action, and impact. Out of 21 definitions viewing the nature of CSR as actions, twelve see them as actors’ *reactive* actions, two as *reactive and proactive*, and seven as *proactive* actions, the latter representing only 8% of the definitions and descriptions. Hence, most definitions consider that minimizing or remedying any harm caused by the managers’ and/or companies’ activities is sufficient. The small number that requires deliberate actions to support social responsibility includes both earlier, such as Eells and Walton (1974, 247) “... the corporate social responsibility movement represents a broad concern with business’s role in supporting and improving that social order” and more recent studies (e.g., Mellahi et al., 2016), so no clear shift toward more proactive forms of action is evident. Giving equal weight to deliberate actions and preventing or remedying harm remains a marginal view. An example is Pinney (2001) “... a set of management practices that ensure the company minimizes the negative impacts of its operations on society while maximizing its positive impacts.”

Table 3 shows the second largest group (16% of the definitions) that sees the nature of CSR as the impact of a company’s (or managerial) actions. Half of the definitions use impact as the sole attribute of the nature of CSR. A recent example is Cronin (2022) “... ability to provide well-being for providers, users, and society.”

Table 3. Definitions of CSR advocating impact as its nature

STUDY	NATURE OF CSR					
	THINKING	ATTITUDE	DECISION, POLICY	PROACTIVE ACTION	REACTIVE ACTION	IMPACT
Davis 1973	x	x			x	x
Epstein 1987			x			x
Lerner & Fryxell 1988						x
Wood 1991			x		x	x
Frederick, Post & Davis 1992						x
Reder 1994					x	x
Gray, Owen & Adams 1996					x	x
Frankental 2001						x
Mohr, Webb & Harris 2001						x
Pinney 2001			x			x
Habisch & Wegner 2005						x
Maon, Lindgreen & Swaen 2010	x					x
Sarkar & Searcy 2016	x			x	x	x
Jamali, Lund-Thomsen & Khara 2017						x
Cronin 2022						x

We move on to discuss *why* CSR is practiced. Of the scholarly definitions and descriptions, 42% indicated that CSR is practiced for its own sake, although a few also add another reason: to benefit the company. Vaaland, Heide, and Grønhaug (2008) provide an example of the latter: “... management of stakeholder concern for responsible and irresponsible acts related to environmental, ethical and social phenomena in a way that creates corporate benefit”. A group of definitions understands CSR as an obligation. For example, Kok et al. (2001, 287) phrase it:

“... the obligation of the firm to use its resources in ways to benefit society, through committed participation as a member of society, taking into account the society at large, and improving welfare of society at large independently of direct gains of the company.”

Finally, 11% of the definitions state that CSR is practiced only because it benefits the company, although none present it as part of a company’s risk management.

What are the *components* of CSR? A majority (62 %) of the studies approach social responsibility as a core component of the definition of CSR. However, 38 % of the definitions do not mention social responsibility and expressly include economic (e.g., Friedman, 1962), ethical (e.g., Maon et al., 2010), or legal components (Carroll, 1979). Notably, none of the definitions mention cultural responsibility (see Maon & Lingreen, 2015).

We next examine the 62 % majority of definitions that refer explicitly to social responsibility, either solely or alongside one or more other components. We start with the latter group. Table 4 shows that of the studies that incorporate economic responsibility into CSR, two (Carroll, 1979; Elhauge, 2005) also included ethical responsibility, and, in addition, Carroll (1979) mentions philanthropy. Carroll (2021) discussed raising economic responsibility as part of the business case for CSR to encourage companies to accept the concept. In other words, the addition reassures companies that CSR need not jeopardize profit maximization, although that is exactly what Manne (1972, 4) argues that CSR should stand for:

“Any working definition of the idea of corporate social responsibility must begin with the idea that the expenditure or activity be one for which the marginal returns to the corporation are less than the returns available from some alternative expenditure. That is not to say that the company must in absolute terms lose money but simply that it makes less money than would otherwise be the case.”

Nevertheless, since the primary aim of most companies is to generate profit, including an economic component in a definition that stresses the importance of social responsibility seems unnecessary to us, unless economic responsibility refers to something other than making a reasonable, but not maximal, profit.

Table 4. Definitions advocating social and economic components

STUDY	SOCIAL RESPONSIBILITY	ECONOMIC RESPONSIBILITY	ENVIRONMENTAL RESPONSIBILITY	ETHICAL RESPONSIBILITY	PHILANTHROPY
Heald 1957	x	x			
Frederick 1960	x	x			
McGuire 1963	x	x			
Johnson 1971[1]	x	x			
Davis 1973[2]	x	x			
Eells & Walton 1974	x	x			
Carroll 1979	x	x		x	x
Drucker 1984	x	x			
Hopkins 2003	x	x			
Elhauge 2005	x	x		x	
Sarkar & Searcy 2016	x	x			

Another way to stretch the boundaries of a CSR definition is to add an environmental component to it (e.g., Eilbert & Parket, 1973; Frederick et al., 1992; Foran, 2001). Eilber & Parket (1973, 7) express it as follows:

“... the commitment of a business or Business, in general, to an active role in the solution of broad social problems, such as racial discrimination, pollution, transportation, or urban decay.”

Although appearing in fewer definitions than economic responsibility, we note that this small group of definitions excludes the economic component, but includes another, environmental responsibility.

A small group of studies (13 %), such as Aguinis (2011) and Khoury et al. (1999), defines CSR in terms of the triple bottom line concept (Elkington, 1997), embracing social, economic, and environmental components. Most of these definitions appear during the early part of the twenty-first century (2001–2014). Two of the studies, Hardjono and van Marrewijk (2001) and Vaaland et al. (2008), also include an ethical component to the description of CSR. Hardjono and van Marrewijk (2001, 225) express it as follows,

“... simultaneous pursuit of economic prosperity, environmental quality and social equity. Therefore, business excellence ultimately implies that corporations integrate social, ethical and environmental criteria into their investment decision-making processes.”

Although we have now discussed three groups of definitions that incorporate philanthropic, economic, environmental, or ethical components into the definition of CSR, those focused solely on social responsibility remain the largest group (25%). The period covered by definitions of CSR that restrict the sole focus to social responsibility starts from Clark (1926) and extends to Mellahi et al. (2016) in our data.

6 The results

6.1 Illustrating and Contrasting the Conceptual Maps of CSR

Conceptual maps illustrate the dominant understandings of CSR. Micro-entrepreneurs (Figure 3) understand CSR in terms of proactive actions, decisions, or policies made by the company and its agents, considering specific target groups, such as employees, customers, and members of the value chain. From that perspective, CSR is practiced for its own sake, based on the entrepreneurs' values.

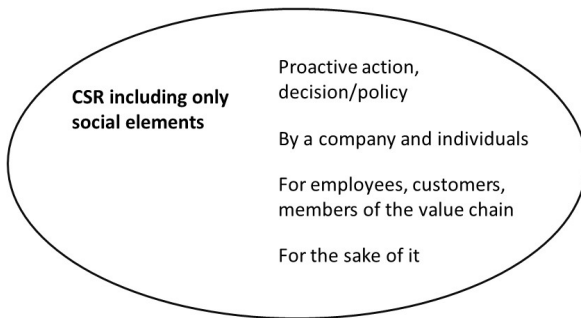


Figure 3. A conceptual map of micro-entrepreneurs' understanding of CSR

The understandings of public authorities are highly fragmented, as reflected in the low number of attributes in the conceptual map below (Fig. 4). The dominant understanding of public authorities sees CSR as a triple bottom line concept. The other common attributes are that the actors are companies and that the companies practice CSR for the benefit of society or stakeholders.



Figure 4. A conceptual map of public authorities' understanding of CSR

There are multiple scholarly views, which are represented in Figure 5, which combines information from five conceptual maps, each representing similar definitions. First, corporate social responsibility can be understood as only constituting social responsibility (the black oval), which includes companies as actors, targets society, is reactive, and is undertaken for its own sake. Second, CSR can be perceived as a combination of social and economic responsibility (the blue oval), which a company practices for the benefit of society and for its own sake, while also deriving a benefit from it. Moreover, CSR exists at the level of thinking, not explicitly at the level of action. Third, CSR is viewed as incorporating social and environmental responsibility (the yellow oval, dotted line) and, interestingly, including employees and community as target groups alongside society. Nevertheless, the view reflects companies reacting to the CSR concept without any consensus on why CSR should be practiced.

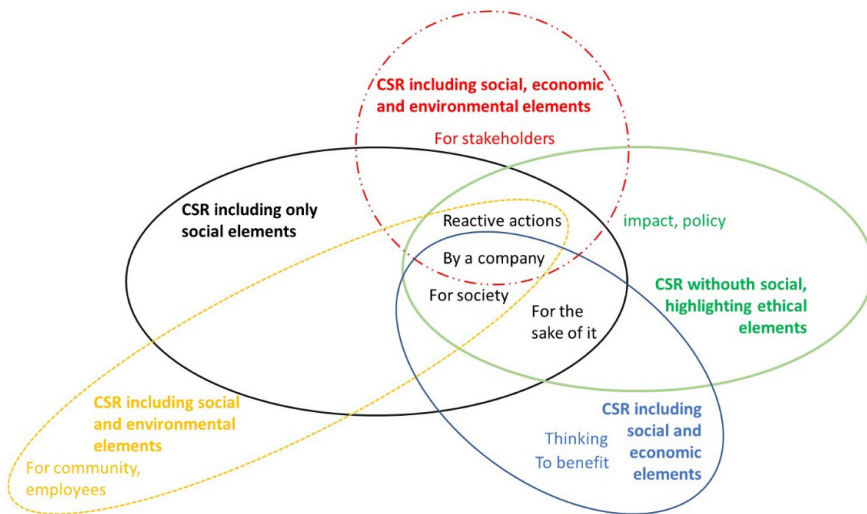


Figure 5. Conceptual maps of scholars' understandings of CSR

Fourth, the triple bottom line view of CSR (the red oval, semi-dotted line) is the briefest. Corporate social responsibility encapsulates companies' reactive activity targeting stakeholders. Finally, a view highlighting company ethics (the green oval) views CSR as reactive actions, company policy, or impact on society, performed for its own sake. The only shared content of the five distinct groups of definitions is the company level. The views reflect not only the absence of a collective understanding but also various understandings that lack commonality. Accordingly, previous studies can refer to vastly differing phenomena, although using the same concept, an aspect that researchers should acknowledge.

Overall, the conceptual maps (Figs. 3-5) can be used to specify and refine the CSR concept, thereby improving its construct validity and scope (Fisher & Aguinis, 2017; Koleva & Meadows, 2025).

Next, we contrast the conceptual maps of the three parties. Most conceptual maps of scholars differ significantly from those of entrepreneurs, the closest being the scholarly view of CSR that includes only the social component (see Table 5). However, the only similarity, in addition to the social component, is the reason for CSR activity: for the sake of it.

Table 5. Contrasting the understandings of CSR

ATTRIBUTES	MICRO-ENTREPRENEURS' UNDERSTANDING	PUBLIC AUTHORITIES' UNDERSTANDING	SCHOLARLY UNDERSTANDING
Actors	Individuals, company	Company	Company
Stakeholders targeted	Employees, customers, members of the value chain	Stakeholders, Society	Society
Nature	Proactive action, decision/policy	-	Reactive action
Components	Social	Social, economic, environmental	Social
Reasons	For the sake of it	-	For the sake of it

Hence, the understandings of micro-entrepreneurs and scholars differ in three other attributes. The nature of CSR clearly sets the dominant scholarly view apart from the entrepreneur’s view. The dominant scholarly understanding is that companies act reactively, whereas micro-entrepreneurs’ CSR involves proactive actions, decisions, and policies. Scholars consider companies as the actors, whereas micro-entrepreneurs clearly see that individuals make decisions and are active actors in CSR. Likewise, micro-enterprises target specified stakeholder groups. Scholarly understandings express the target groups only on a highly abstract level. Finally, all other versions of the scholarly understandings (see Figure 5) differ more than the one discussed above.

The difference in the abstraction level might result from scholarly definitions tending to be abstract and simplified (Weick, 2007), whereas entrepreneurs discuss the routine activities of their companies. Another explanation may be the different approaches to conceptualization of the parties (Durose et al., 2022). Academics use concepts to build theory, which is different from when people apply concepts to enable change (Durose et al., 2022). The micro-entrepreneurs we interviewed could be strong defenders of social sustainability; however, such differences in understanding CSR surely hinder communication in transdisciplinary research.

Moreover, the micro-entrepreneurs’ understanding and the public authorities’ understanding of CSR differ considerably. None of the attributes is the same. Likewise, the scholarly understanding closest to the entrepreneurs’ one shares only one attribute, the company as the actor, with the public authorities’ view. However, the latter is closer to the version of scholarly understanding that includes social, economic, and environmental components into the definition of CSR, seen in Figure 5.

If we scrutinize the meanings micro-entrepreneurs ascribe only rarely to CSR, they include considering CSR a means of risk management, an attribute also absent from the scholarly definitions. One attribute of social responsibility, sometimes referred to in literature, did not emerge in the interview data: social responsibility actions as employer brand-building to attract prospective employees. The reason may be that many of our informants were solo entrepreneurs who did not plan to recruit staff. Similarly, scholarly definitions do not address the cultural components of responsibility or the role of entrepreneurs and their families as stakeholders. Only Khoury et al. (1999) include an entrepreneur as a stakeholder. Entrepreneurs nominated customers as stakeholders more frequently than scholars did.

This exercise shows that when initiating a transdisciplinary research project, the parties’ understandings of the key concept and the phenomenon it refers to can differ considerably. That is precisely why using the modified CAM is productive; it reveals the differences so that they can be discussed and understood. The differences detected also serve to contrast; they highlight the variation in the concept of CSR across different contexts. Utilizing the modified

CAM can thus improve the logical and empirical adequacy of the concept (Fisher & Aguinis, 2017; Koleva & Meadows, 2025). In addition, modified CAM can be used to facilitate a dialogue with the parties to formulate a conceptualization that can be used to advance transformative CSR research.

6.2 Contextual Conceptualization of Micro-Enterprise CSR

This study’s findings suggest that when studying micro-enterprises, the definition of CSR needs to be contextualized. It should include individuals, both as actors and beneficiaries, and proactive actions, not only reactive ones or the impact of the company’s actions.

Moreover, the findings suggest that we as scholars have forgotten the Brundtland Commission’s (1987) statement and its aim of eliminating poverty, limits to growth, and focus on current and future generations. In addition, the way some scholarly and public authorities’ definitions include economic responsibility into CSR dilutes the understanding explicit in early CSR discussions, such as Manne (1972), where CSR sets limits to maximal profit.

Hence, to advance CSR in the micro-enterprise context, we advocate for contextualization and combine the above views into the following definition: Micro-enterprise CSR refers to companies and their agents acting proactively to meet the basic needs of current and future employees, customers, and other stakeholders, despite the limitations on economic growth and profits.

6.3 The Steps of Modified CAM

This study modified the original CAM for two purposes: to develop a conceptual theory (discussed in sections 6.1 and 6.2) and to facilitate communication in transdisciplinary research. To advance the latter, we summarize the steps of the modified CAM in Table 6.

The first step involves collecting data that can reveal all the participants’ understanding of the key concept. The data collection can include interviewing representatives of both non-academic and academic entities and collecting documents that reflect the understanding of public authorities. This data can then be analyzed inductively, or researchers could use the areas of theoretical contribution provided by Whetten (1989) as categories. That can be a time-consuming task, but overall, utilizing the CAM is not a long-term exercise.

Table 6. The steps of the modified CAM

STEP	PARTICIPANTS	METHODS	KEY REFERENCES
1. Collect the data	Non-academics Public authorities Academics	Interviews, focus groups, and written sources Written sources, interviews Scholars participating in the transdisciplinary study, review of studies representing the involved disciplines,	Tähtinen & Havila (2019)
2. Categorize the meanings	All	Date driven content analysis or What, How, Why, Who, Where	Krippendorff, 2004 Whetten (1989)
3. Draw conceptual maps	All	Discussion with the participants, adjusting if needed	Tähtinen & Havila (2019) Tähtinen & Suomi (2022)
4. Compare the conceptual maps for a common language	All	Dialogue among the participants	Kieser & Leiner (2012), Grafström et al. (2023)
5. Compare the conceptual maps for theory elaboration	Academics	Concept specification, Contrasting	Fisher & Aguinis, (2017), Koleva & Meadows (2025)

The third task is to transfer the understandings to conceptual maps of each group of participants. We advise discussing the participants' understandings of the key concept to ensure they are accurately represented. The fourth task is a dialogue where the participants compare and discuss the conceptual understandings distilled in conceptual maps or tables, such as Table 5. Thereafter, a joint decision can be made on the common language to be used in transdisciplinary research or how to continue to study and advance CSR, respecting the parties' different understandings. The result of the discussion can be a temporary knotting (Grafström et al., 2023), where the difference in understandings is eased temporarily, for the duration of the study.

As the fifth task, scholars could extend the use of the modified CAM to support theory elaboration, based on the conceptual maps, to concept specification or refinement and contextualized definitions through contrasting activity (Fisher & Aguinis, 2017; Koleva & Meadows, 2025).

8 Conclusions

The concept of CSR is contested and has multiple conceptualizations and meanings among scholars, public authorities, and micro-entrepreneurs, as well as between those groups (Okoye, 2009; Mitnick et al., 2021). The multiple meanings or strands of research and use contexts (Lund-Thomas, 2020) make it challenging to forge shared understandings and collaboration efforts in research and practice to enhance CSR and measure the impact of such efforts. That is particularly true when collaborating with micro-entrepreneurs and small companies. Hence, transdisciplinary research requires contextual conceptualization of the key concept to facilitate a common language among the parties.

The definition of micro-enterprise CSR suggested in this study relates to what Mitnick et al. (2021) call the injunctive/social CSR research perspective, common in business and society/business ethics literature. The guiding elements of the injunctive perspective are individuals' and companies' ethics, societal values, and the actors' orientation toward reducing harms and increasing benefits at the societal level (Mitnick et al., 2021). These assumptions connect with the micro-entrepreneurs' understanding of CSR, which empirically grounds the definition suggested in this study.

The results offer the CSR understandings of three parties often present in transdisciplinary research. Okoye (2009) suggests that corporations can use the concept of CSR defensively, whereas non-governmental organizations use it aggressively when promoting CSR. Interestingly, the micro-entrepreneurs' understanding presented in this study is not defensive, nor is the public authorities' understanding aggressive. Some of the interviewed micro-entrepreneurs saw their CSR as business as usual, and all shared an interest in advancing CSR. This supports the results of Lepoutre and Heene (2006) and Soundararajan et al. (2018) in the SME context, suggesting that if owner-managers recognize social responsibility issues, they will find ways to contribute to resolving them.

The results of this study confirm that differences in understanding CSR persist despite calls to establish common meanings for key research concepts (Godfrey & Hatch, 2007; Lindgreen & Swaen, 2009). This study focused on the concept of CSR because scholars, policymakers, and practitioners have used the term for a considerable time. However, the introduction of the environmental, social, and governance (ESG) acronym (World Bank Group, 2017) has spawned several studies (Berg et al., 2022; Clément et al., 2025; Pollman, 2024) on its definitions and measurement to highlight a similar lack of consensus. Hence, regardless of which concept or acronym is used, there remains a need to clarify how the parties understand it.

Referring to Gallie (1956), Okoye (2009) argues that as an essentially contested concept CSR does not need a universal meaning. However, Okoye (2009, 623) calls for a common reference point, exemplar, or core to identify “the common basis that indicates that all such arguments relate to the same concept”. We suggest that the attributes on CSR that emerged in the inductive data analysis of this study could be useful categories when discussing the common basis. Including the actors, the nature, the components, the targets, and the reasons for CSR could help craft definitions that share core attributes and are comparable. The content of the attributes would still differ, influenced by the context. Such a structure would allow the flexibility that Okoye (2009) supports, as circumstances and times change. Following Whetten (1989), we would add an attribute of “When” to show that the future matters in CSR.

This study modified the original CAM (Tähtinen & Havila, 2019; Tähtinen & Suomi, 2022) to provide a tool for transdisciplinary research and theory elaboration. This study demonstrates that the CAM can be modified into a tool to foster mutual understanding, despite not being developed for this purpose or previously applied to such a task. The modified CAM helps to compare and map how different groups use and understand a concept. Such maps provide a starting point to determine how concepts will be conceived of and used in the project in question. Moreover, comparing the resulting conceptual maps can advance theory elaboration, as they reveal contextual differences.

Using the modified CAM to advance theory elaboration is subject to some constraints. The compilation of scholarly definitions of CSR, which mostly relied on existing reviews, may have resulted in some definitions being overlooked. However, using multiple reviews reduced that risk to an acceptable level. Nonetheless, we acknowledge that this study does not cover every definition of CSR.

Schneider (2020) argues that CSR has failed and could succeed only in welfare states, such as Finland, where this study’s informants, the micro-entrepreneurs, are based. Our interpretation of how some of the studied scholarly definitions, particularly those within the instrumental/economic CSR research perspective (Mitnick et al., 2021), understand CSR is equally gloomy. Only a few scholarly definitions view CSR as comprising proactive activity, in other words, protecting and enhancing social responsibility, despite its influence on profits. Most scholarly definitions view it as sufficient to react only when the company’s actions jeopardize social responsibility or to mitigate the negative impact of such activity.

For future research, we ponder the following questions. Has CSR research been overly focused on large corporations? Has it overlooked the fact that at the root of all CSR decisions are people who represent the companies they work for or own, regardless of their size? Should managers and companies act proactively to support a worthwhile cause instead of merely trying to avoid acting irresponsibly? How can value-based CSR be practiced if only the current impact matters? Should companies measure the actual impact, or should they estimate the impact of their actions in advance to ensure that the overall future impact will appear positive (or at least not too negative) to all stakeholder groups? If stakeholders remain unspecified or highly abstract (e.g., society), how can companies genuinely measure their CSR impact?

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Are Mandatory Auditing Requirements in Small Firms Justified by their Benefits? A Literature Review¹

Irina Alexeyeva, Peter Frii, Ann-Sofie Henrikson, Annina H. Persson, Oscar Stålnacke and Stefan Sundgren

Abstract

The regulation of auditing for privately held firms varies across the world. While countries such as the United States and Canada impose no general audit requirement for private firms, many European Union (EU) Member States mandate audits even for small entities. The EU Accounting Directive (2013/34/EU) sets minimum thresholds for audit exemptions but allows Member States to adopt stricter national rules, creating variation across the EU. This paper reviews theoretical and empirical literature on the regulation of private-firm auditing. It explores justifications for audit mandates for small private firms, including externalities, behavioral considerations related to tax compliance and financial misconduct, and costs and benefits of voluntary auditing. In addition, the study reviews legal frameworks for statutory audits in selected EU countries and highlights how national policies and risk assessments shape audit thresholds and enforcement strategies. The review concludes by identifying gaps in the literature and suggesting areas for future research.

Keywords:

Mandatory audits; audit costs; audit benefits; audit regulation

Irina Alexeyeva is an Associate Professor at Umeå School of Business Economics and Statistics, Umeå University, Sweden.

Peter Frii is an Associate Professor at Umeå School of Business Economics and Statistics, Umeå University, Sweden.

Ann-Sofie Henrikson is an Associate Professor at the Department of Law, Umeå University, Sweden.

Annina H. Persson is a Professor of Private Law at Royal Institute of Technology, Sweden.

Oscar Stålnacke is an Associate Professor at Umeå School of Business Economics and Statistics, Umeå University, Sweden.

Stefan Sundgren is a Professor of Accounting at Hanken School of Economics, Finland, and a Guest Professor at Umeå School of Business Economics and Statistics, Umeå University, Sweden.

¹We thank an anonymous referee for valuable comments and the Swedish Research Council for financial support (project 2022-05453).

1. Introduction

The regulation of private-firm auditing varies significantly around the world. In the United States and Canada, private firms are not obligated to audit their financial statements, and therefore, only about one-third of all medium to large private firms prepare audited financial statements (Lisowsky & Minnis, 2020). In contrast, the general rule for private companies in EU Member States is that they must audit their financial statements. This requirement can be economically and administratively burdensome for small companies. For this reason, exemptions were introduced for small firms in the Accounting Directive, 2013/34/EU.² However, the Directive serves as a minimum harmonization instrument, which means that it only prescribes mandatory auditing for companies that exceed certain thresholds. Member States are allowed to impose audit requirements on smaller companies whose sizes fall below the thresholds.

Mandatory auditing has been a political issue in some European countries for many years (Accountancy Europe, 2020). In some countries, as for example in Sweden, the absence of mandatory auditing has been linked to increased economic crime, leading to proposals for lowering the thresholds that trigger audit requirements. Historically, however, the rationale for mandatory auditing has rarely been justified in detail in the Swedish legislation. The debate has instead mostly focused on the role of the auditor in the fight against tax fraud and other financial crimes. However, no detailed evaluation of the auditor's role in this regard has taken place. The abolition of mandatory audits in micro firms was primarily justified as a means to reduce costs and ease the administrative burden for small companies.³

The diversity of regulations across countries makes it difficult to evaluate the advantages and disadvantages of auditing. Numerous theoretical and empirical studies have been conducted to shed light on voluntary and mandatory auditing in general. Literature on private-firm auditing has been reviewed previously (Haapamäki, 2018; Vanstraelen & Schelleman, 2017). However, these reviews primarily focus on determinants of voluntary audit choices and on the economic benefits of being audited. The focus of those studies is not on mandatory auditing per se. The reviews by Minnis and Schroff (2017) and Langli and Willekens (2018) do address some of the benefits and costs associated with audit mandates. However, in this article, we aim to provide a more comprehensive and integrated review of both theoretical and empirical research on the topic.

The overall purpose of this study is to present a summary of what can be learned from the literature about the benefits and drawbacks of mandatory auditing for small, privately held firms. More specifically, we aim to gain insight into the factors and circumstances presented in the literature that support auditing, as well as those that challenge the justification for mandatory audits. In addition, we review research on the firm-specific costs and benefits of voluntary audits to assess whether firms have sufficient incentives to opt for audits even in the absence of mandates. Finally, we identify gaps in the existing literature to suggest directions for future research. Specifically, the study addresses the following research questions:

RQ 1: What can be learned from research about factors and circumstances that motivate mandatory audits?

² Art. 36 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings.

³ SOU 2008:32 s. 71–77.

RQ 2: What can be learned from research on the firm-specific costs and benefits of voluntary audits?

RQ 3: What are the research gaps in the literature on mandatory auditing?

To complement the literature review, we examine the legal framework for mandatory auditing in the European Union and selected Member States to illustrate how audit requirements are applied in practice. While the EU Accounting Directive in many respects merely stipulates minimum requirements, Member States are allowed to impose stricter national rules.⁴ This flexibility has resulted in considerable variation in the thresholds for audit exemptions across the EU. By comparing audit thresholds, national adaptations, and recent legislative trends in five EU countries, Denmark, Finland, Sweden, Germany, and Spain, we aim to illustrate how different national contexts and policy rationales shape the implementation of mandatory audit requirements.

The study begins in chapter two with a presentation of the research method used. Chapter three provides a review of the legal requirements for auditing in some EU member states, including a summary of the threshold applied. We then present insights from the debate on the advantages and disadvantages of mandatory auditing, as well as having stricter auditing requirements for high-risk firms in Denmark. This is followed in chapter four by a review of theoretical studies on the benefits and drawbacks of mandatory auditing. Chapter five presents empirical studies on the effects of mandatory auditing in certain industries and on the market in general. Chapter six concludes the study by summarizing the main findings and offering directions for future research.

2. Research Method

The review is based on an electronic search of library journal databases for both published research and completed working papers available online. Key search terms included “mandatory audits”, “compulsory audits”, “audit requirements”, “audit costs”, “audit benefits”, and related variations. Furthermore, we have conducted a manual search of reference lists in relevant papers to identify additional sources. Identifying relevant disclosure and behavioral research in law and economics is challenging, as it is difficult to define specific search terms that would consistently identify literature relevant to audit mandate motivations. Therefore, that part of the review relies heavily on prior review articles (e.g., Beyer et al., 2010; Jolls et al., 1998) and manual reference tracing. Given the vast scope of research on auditing and regulation, a fully comprehensive review is beyond the scope of this study. Instead, we focus on a subset of literature that offers insights directly applicable to mandatory auditing.

The following inclusion criteria were applied to select relevant studies for this review. Firstly, the studies were included if they provided theoretical or empirical insights into factors that motivate audit mandates, including firm-level considerations and broader regulatory discussions. Secondly, we considered studies that addressed the costs, benefits, or implications of auditing for private companies, with a particular focus on mandatory audit requirements or voluntary audit decisions. Thirdly, disclosure and behavioral research were reviewed, provided they offered insights applicable to the audit mandate context. Fourthly, only studies published in peer-reviewed journals or reputable academic outlets were selected. Fifthly, to ensure a high quality of publication, we rely on the Association of Business Schools (ABS) Academic Jour-

⁴ Of relevance in this article art. 36 Directive 2013/34/EU.

nal Guide 2021, including journals ranked as 4*, 4, 3 and 2, with 4* representing journals of the highest quality. This largely corresponds to the Australian Business Dean Council (ABDC) journal list using the abbreviation as A*, A, B or C, with A* representing journals of the highest quality. In addition, completed working papers published online were included when they provided recent findings or research advancements relevant to our research questions. Including unpublished papers can enhance the comprehensiveness and depth of the literature review. However, it is important to exercise caution when using unpublished papers. Therefore, we critically evaluate the quality, reliability, and relevance of these papers, considering the authors' reputation and the rigor of the research design.

The review is based on 64 papers, of which 22 are theoretical (analytical) or empirical studies on voluntary auditing or audit mandates. Most of the remaining 42 papers are theoretical, empirical, or review articles focused on disclosure regulation or behavioural economics. We draw on these papers in our attempt to understand factors that could motivate audit mandates in Section 3. Table 1 summarizes the analytical studies on audit mandates. The 15 articles reviewed in Table 2 focus on firm-specific benefits of auditing. The two papers presented in Table 3 examine firm-specific costs, while the three papers presented in Tables 4 and 5 are empirical studies focusing on the market-wide effects of mandatory auditing. The legal discussion in this article is based on the European legislation and national acts obtained from EUR-Lex and national public databases provided by authorities, and the relevant academic literature. The selection of countries in Section 3 aims to highlight the diversity and in some cases and extremes of national statutory auditor requirements.

Since the analytical literature on audit mandates is scant, and audit mandates essentially is a way to regulate disclosure quality, we utilize disclosure theory to investigate the conditions under which such mandates may be warranted. Our review of the theoretical literature also incorporates insights from behavioral economics literature, which we apply to the context of mandatory auditing. We do this because entrepreneurs running small businesses are generally not experts in accounting or legal issues. Therefore, the assumptions found in behavioral economics literature may better explain their behavior than models based on rational utility maximization.

Analytical literature typically produces hypothetical effects, which are not necessarily empirically tested or supported. To better understand what is known (and what remains unknown) about audit mandates from the empirical literature, we next review studies examining firm-specific benefits, costs and market-wide effects of mandatory auditing. The (scant) literature on market-wide effects is reviewed with a particular focus on the broader consequences of audit mandates. The final aims of the study are to summarize what can be learned about audit mandates from the existing literature and to suggest fruitful areas for future research.

3. Mandatory Auditing in EU Countries

In this section, we present the European Union (EU) mandatory auditing requirements and provide detailed insights into the auditing regulations of several specific EU countries. The harmonization of accounting rules has been an important part of the work to create a common European corporate and capital market (Thorell, 1993). In order to guarantee that accounting information is equivalent in the Member States, Directives 2006/43/EC⁵ and 2013/34/EU contain

⁵ Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts.

provisions to ensure that companies' results and position are reported in a fair manner. A European standardization of companies' financial reporting can be expected to promote equal treatment of owners and stakeholders in different countries. Developments within the EU have thus come to develop towards higher requirements for accounting and auditing and that the review of the accounts must then be carried out by qualified auditors according to high standards. The provisions were designed with large and listed companies as a starting point. At the same time, it was found that the need for protection for shareholders and other actors who come into contact with small companies is often considerably less than in larger operations. In smaller companies with only one or a few owners, who may not infrequently be the same as those who run the business as board members and employees, there is no need for an auditor to provide insight into and control over the company's finances.⁶ Consequently, exemptions for smaller companies were already introduced in the Fourth Company Law Directive.⁷

In the accounting directive 2013/34/EU, the preamble states that a clear objective of the directive is to reduce the administrative burden and improve the business environment for SMEs. Reference is made, among other things, to the Commission's Better Regulation Programme "Smart Regulation in the European Union" and the Commission's Communication "Think Small First: A Small Business Act for Europe".⁸ The aim of the former is to design and introduce legislation of the highest quality, respecting the principles of proportionality and subsidiarity, and to ensure that the administrative burdens are proportionate to their benefits. The Commission's Communication draws attention to the role of SMEs in the growth of the Union economy and the importance of increasing the competitiveness of companies.⁹

Article 36 of the accounting directive provides for the possibility for Member States to make derogations for micro enterprises. A micro-enterprise is defined as an enterprise which, on the balance sheet date, does not exceed the thresholds of more than two of the following three criteria: a) A maximum balance sheet total of EUR 450 000, b) A net turnover not exceeding EUR 900 000, or c) An average number of employees during the financial year not exceeding ten persons.¹⁰ Derogations are also possible for small enterprises. A small enterprise is defined as an enterprise which does not have activities that exceed two of the following three criteria on the balance sheet date: 1. A balance sheet total of EUR 5 000 000, 2. A net turnover of EUR 10 000 000 and 3. The average number of employees during the financial year must not have exceeded 50 persons.¹¹ However, Member States may set higher thresholds for balance sheet total and net turnover as long as they do not exceed EUR 7 500 000 for balance sheet total and EUR 15 000 000 for net turnover, respectively.¹² The monetary size criteria were increased by 25 per cent through the 2023 amendment to the Accounting directive, thereby reducing the number of undertakings subject to mandatory statutory audit.

6 Preamble (43) of Directive 2013/34/EU.

7 Art. 51, 11, 12 and 44 of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies.

8 Preamble (1) Directive 2013/34/EU.

9 https://commission.europa.eu/law/law-making-process_en, 2026-06-15, and European Commission Communication (COM(2008) 394 final) — 'Think small first' — A 'small business act' for Europe, <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:et0001>, 2026-06-15.

10 Art. 1 sec. 1 a and b, Commission delegated directive (EU) 2023/2775 of 17 October 2023 amending the accounting directive.

11 Art. 3 sec. 1 (c) Commission delegated directive (EU) 2023/2775 of 17 October 2023 amending the accounting Directive.

12 Art. 3 sec. 2 (a) and (b) Commission delegated directive (EU) 2023/2775 of 17 October 2023 amending the accounting Directive.

However, the exemption from ensuring that the company's accounts are audited is designed in such a way that each Member State may, but does not have to, make an exception to the audit requirement.¹³ The directive states that a national exemption should be designed taking into account the specific conditions and needs of its own markets.¹⁴ This means that the thresholds for when an auditor must be present differ between different Member States. In a longer-term perspective from 2006–2021, however, it can be stated that the thresholds have been increased in most Member States, with the consequence that, over time, a growing number of companies in most Member States have become exempt from statutory audit.

There are large differences between the levels of the Member States' thresholds. It can be noted that three countries, Sweden, Finland and Malta, stand out as the countries with the lowest thresholds and thus require an auditor even for smaller operations. This can be compared with Germany which has made full use of the discretion afforded by EU law by setting their national audit-exemption thresholds at the maximum balance sheet total and net turnover levels permitted under the Accounting Directive.

We proceed with an overview detailing how five different EU countries have implemented the requirements of the EU directive. Additionally, this section provides insights into national differences in legislation on the role of mandatory audits.

Denmark: In Denmark, several relaxations of the audit requirement have been implemented since 2006, when the Danish Parliament introduced a law that small companies were no longer required to have an audit. Since 2006, Denmark has allowed small companies (class B undertakings) to opt out of statutory audit. Subsequent increases in the applicable size thresholds, introduced in several stages, have meant that an increasing number of companies fall within the audit exemption. Companies are now exempt from the audit requirement if two of the following three thresholds are not exceeded for two consecutive years, namely 1) a maximum of 12 employees, 2) DKK 4 million (535 200 €) in balance sheet total and 3) DKK 8 million 41 070 000 €) in net turnover.¹⁵ These thresholds align with the extended thresholds specified in the EU directive.¹⁶

However, Danish legislation has certain limitations on the possibility of opting out of auditing even if the company does not exceed the thresholds. According to these provisions, a company may not opt out of an audit if the company itself, a related company or the person who has a controlling influence over the company, has been fined or convicted of a breach of the anti-money laundering legislation, Companies Act, the Accounting Act or the tax legislation. In such cases, the company may not opt out of audit for the financial year in which the decision becomes final and for the two subsequent financial years. Furthermore, the Danish Business Authority (Erhvervsstyrelsen) is empowered to suspend the audit exemption for an additional period of up to two financial years where significant errors or deficiencies are identified in the undertaking's financial statements or bookkeeping.¹⁷

In 2021, a broad political majority in Denmark agreed to increase efforts against fraud and errors in accounts and tax reports. The agreement led to legislation that came into force on the 1st of July 2022 and applies from the financial year beginning on or after the 1st of January 2023. The changes in the law meant, among other things, that companies with more than 50 million DKK (about 6.5 million €) in total assets should not be able to opt out of audit or ex-

13 Art. 36 Directive 2013/34/EU.

14 Preamble (14) Directive 2013/34/EU.

15 § 22a and 135 (1) årsregnskabsloven (Annual Accounts Act) LBK nr 402 af 26/03/2026.

16 Art. 3 (2) of Directive 2013/34/EU.

17 See § 135a årsregnskabsloven (Annual Accounts Act).

tended review, regardless of net turnover and number of employees. The changes in the law also entailed stricter requirements to hire an auditor for companies that have a net turnover of over 5 million DKK for two consecutive financial years and that operate within one of eleven specially designated high-risk industries. Depending on how the companies are classified, the auditor must provide different types of review or statements.¹⁸ The high-risk industries do include areas of business activity where many companies make mistakes in the declarations or do not pay VAT or other taxes on time, as cleaning services, transport and haulage services or restaurants and catering.¹⁹

Particularly interesting to note is that in a Danish evaluation (Erhvervsstyrelsen, 2018), it was also found that in companies where there is an intention to commit economic crime, mandatory auditing would probably not lead to better detection of illegal activities because it takes a long time (in some cases up to 23 months) before the annual report is audited. Therefore, individuals with criminal intent have plenty of time to commit crimes before the auditor comes into the picture.

Finland: In Finland, which has the most extensive requirements for mandatory auditing, auditing becomes mandatory already if more than one of the following criteria is met: (a) net turnover is greater than EUR 0.2 million, (b) total assets are over EUR 0.1 million, or (c) an average number of employees during the financial year exceeds 3 people.²⁰ Consequently, Finland has together with Sweden, Malta, and Cyprus the lowest thresholds for auditing in the EU. In 2018, it was proposed that the threshold should be raised to 10 employees, EUR 0.35 million in assets, and EUR 0.7 million in net turnover. However, this proposal did not lead to legislative change, partly due to concerns about its potential impact on the “gray economy”. In 2020 a working group proposed mandatory reviews instead of full audits of micro-companies. Currently, this has not resulted in a change of the regulation.²¹

Sweden: In Sweden, only smaller businesses are exempt from the statutory audit requirement, and until 2010, auditing was mandatory for all companies in Sweden, regardless of size. However, starting from 2011, the criteria changed: auditing is now required if a company exceeds more than one of the following thresholds: a) the average number of employees in the company has been more than 3 in each of the last two financial years, b) the company's reported balance sheet total has been more than SEK 1.5 million (approximately 0,13 million Euro) in each of the last two financial years, c) the company's reported net turnover has been more than SEK 3 million (approximately 0,27 million Euro) in each of the last two financial years.²² Consequently, compared to other EU countries, Sweden has low thresholds for mandatory auditing. A significant aspect of Swedish legislation is the duty imposed on auditors regarding suspicions of criminal activities by company executives. If an auditor suspects that a board member or the managing director is involved in crimes, such as fraud or money laundering, the auditor should inform the board of directors. If the board does not take appropriate actions (for example because the board is involved in the crime), the auditor is then obliged to inform a prosecutor about the suspects.²³

18 See § 135 sec. 1-8 årsregnskabsloven (Annual Accounts Act).

19 See Bekendtgørelse om fastsættelse af klassificerede risikobrancher efter årsregnskabsloven BEK nr. 1488 af 27. november 2025, <https://www.retsinformation.dk/eli/lt/a/2025/1488>, 2026-03-31.

20 2 § Revisionslag (Auditing act) 1141/2015, reviderad 31/12 2023 genom 1250/2023.

21 Ministry of Employment and the Economy publications 2020:38.

22 Ch. 9 art. 1 aktiebolagslagen (Swedish Companies Act) (2005:551).

23 These rules are in Ch. 9, art. 42-44 aktiebolagslagen (Swedish Companies Act), (2005:551).

Germany: The general rule for companies in Germany is the requirement to undergo an audit. However, exceptions are made for micro companies, which are defined by not exceeding two of the following thresholds: (a) total assets not exceeding 450,000 EUR; (b) 9,000,000 EUR in sales revenue in the twelve months preceding the balance date sheet; or (c) an annual average number of employees not exceeding 10.²⁴ The exceptions for small companies, which are defined by not exceeding two of the following thresholds: (a) total assets not exceeding EUR 7,500,000 EUR; (b) 15,000,000 EUR in sales revenue in the twelve months preceding the balance date sheet; or (c) an annual average number of employees not exceeding 50.²⁵

To summarize, micro or small companies usually never have to undergo audits. However, it is a common practice for such companies to use a tax advisor (Steuerberater), who is responsible for preparing tax declarations, annual reports, and managing salary and fee reports.²⁶ In Germany, there is a strong connection between accounting and taxation, and thereby, the tax advisor has an important role in accounting. The professional role of the tax advisor is regulated, and a special degree is required.²⁷ The tax advisor assures the tax authority that no violations of the tax legislation, or other financial crime have been discovered.

Spain: In 1951, Spain introduced a new limited liability company law which, for the first time, included provisions for auditing in its legal framework. However, these initial regulations stipulated an audit only if it was demanded by a specified percentage of the shareholders. Apart from some minor changes, the issue of mandatory audits in Spain did not gain serious attention until the late 1980s when Spain became a member of EU. The current regulation in Spain mandates auditing unless, at the end of the financial year, a company meets at least two of the following criteria: (a) a net turnover of no more than EUR 5.7 million; (b) a total balance sheet value not exceeding EUR 2.85 million; or (c) more than 50 employees.²⁸ In essence, Spain has set its mandatory auditing requirements at approximately half of the EU's thresholds for net turnover and total assets.

A notable feature of Spanish legislation is the stipulation that the duration of the initial contract with an auditor must be between three and nine years. After this period, the contract may be renewed annually.²⁹ Obviously, the purpose of this rule is to reduce the risk of "audit opinion shopping" (Ruiz-Barbadillo et al., 2006). In contrast to Denmark and Sweden, there is – as we know – no public debate about the role of auditing in deterring financial crimes in Spain.

The pros and cons of low threshold mandatory auditing are currently a subject of debate in Sweden, as of the time of writing this study. Following the abolition of mandatory auditing for all companies in 2010, an evaluation conducted by the National Audit Office (2017) concluded that the disadvantages outweigh the advantages.³⁰ Among other things, the authority finds that the cost savings for companies not using auditors are minimal and that financial reports

24 § 267 Handelsgesetzbuch (HGB). "Aktiengesellschaft" which do not exceed the thresholds are considered small, have an audit obligation according to § 316 (1) HGB and for GmbH § 264a HGB.

25 § 267a and § 267 Handelsgesetzbuch (HGB). "Aktiengesellschaft" and GMBH (Gesellschaft mit beschränkter Haftung) which exceed the thresholds have an audit obligation according to § 316 (1) HGB and § 264 and § 264 a HGB.

26 See § 5 abs. 1 Einkommensteuergesetz (EStG).

27 See § 35 Steuerberatungsgesetz (StBerG) where it is pointed out that an exam is required and that the exam is organized by a committee supervised by the taxation authorities.

28 Art. 263 La ley de Sociedades de Capital (Capital Companies Law), 3rd of July 2010 nr 161. Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital.

29 264 La ley de Sociedades de Capital (the Companies Act) 3rd of July 2010 nr 161. and art. 22 of the Accounting Act (Ley de Auditoria de Cuentas), 20th of July 2015, nr 22/2015.

30 RIR 2017:35.

without audits tend to contain more errors. Additionally, the National Audit Office observed that companies opting out of auditing are often involved in cash-intensive businesses, leading to the conclusion that the fight against financial crime has become more challenging as a result of these legislative changes.

4. A Review of Theoretical Studies on Auditing

This section addresses RQ1 by reviewing theoretical justifications for and against mandatory auditing. Generally, proponents of mandatory audits (and mandatory disclosure in general) claim that information about a firm's financial conditions will be underreported without regulation. They also assert that firms will suppress information if it is unfavorable for them to disclose. Opponents, on the other hand, claim that firms have incentives to voluntarily disclose information in order to differentiate themselves from high-risk and/or low-value firms (e.g., Dye, 1990; Lennox & Pittman, 2011). Consistent with the view that audit mandates are unnecessary, Watts and Zimmerman (1983) find in their analysis of the historical development of auditing that it arose voluntarily as a demand-driven service rather than as a result of regulation.

This section explains the underpinning of these opposing views. In addition to theories directly related to mandatory auditing, we also base our analyses on theories of mandatory disclosure. The rationale for including this literature is that an audit mandate does not necessarily increase the amount of information disclosed by firms but requires that the financial statements they disclose meet a minimum level of credibility and verification. In this sense, auditing can be viewed as a complement to disclosure regulation because it enhances the reliability of financial information available to external stakeholders (see Beyer et al., 2010). This connection is particularly relevant when considering voluntary audit choices, since firms may use audited financial statements to signal the credibility of their financial information to lenders and other external stakeholders.

Our review begins with a discussion of research examining the effects of mandatory auditing on production costs, audit fees and audit quality in settings where there are no externalities. We then turn to theories on disclosure costs (including externalities) and discuss how such costs may influence auditing choices in an unregulated market. Finally, we present some insights from the behavior economics literature and discuss their potential implications for audit mandates.

4.1. Impact of Mandatory Audits on Audit Quality, Audit Costs and Audit Fees

One might assume that audit mandates increase the quality of audits and audit fees, but some analytical studies suggest this is only half the truth. Ronnen (1996) analyzes how mandatory auditing influences the overall quality of audits and audit fees. He examines a setting where the demand side consists of several client firms, and the supply side includes two audit firms competing on quality and price. The study assumes that audit firms aiming to provide high-quality services make a fixed-cost investment to attain quality, and that each audit firm offers the same quality level to all its clients. In this framework, audit quality becomes differentiated if one of the two audit firms makes the fixed-cost investment to offer higher quality audits. A key finding in the study is that mandatory auditing will make the low-quality auditor less aggressive in its pricing behavior, that is, charging lower fees. Furthermore, compared to an unregulated market, auditing mandates widen the disparity in quality levels offered by audit firms. In es-

sence, mandatory auditing creates the demand for low-quality and low-cost auditing services. The increased disparity in quality will also result in a switch of some clients from lower-quality to higher-quality audit firms.

Breuer et al. (2023) analyze how auditing mandates impact audit fees and the job market for auditors. They present a model where the demand for voluntary audits depends on client firm size. Audit firms can grow by attracting new employees, who will enter the profession if their wage exceeds their outside-option wage. Greater demand for auditors increases wages and, in turn, the marginal cost of auditing. The main predictions of their model are that mandatory audits lead to an increase in the number of auditors and their wages, while decreasing the average size of audit clients. As a consequence of higher wages and audit fees, some voluntary audit demand is crowded out (i.e., clients that would have the incentive to hire an audit in an unregulated market may find the costs too high in a regulated one).

These models suggest that audit mandates may lead to unintended market distortions, such as increased demand for lower-quality audits and reduced incentives for voluntary auditing. Although mandates may expand the audit market, they do not necessarily result in uniform improvements in audit quality. These theoretical insights also inform RQ₁ by highlighting that the motivation for mandatory auditing may depend on how mandates influence audit market structure and incentives. Further empirical research could shed more light on these effects.

4.2. Auditing at an Unregulated Market Without Externalities and Other Market Imperfections

The observation that no audit mandates are required in markets without externalities or other imperfections can be understood by applying the unraveling result at the auditing setting. Research related to the “unraveling result” identifies conditions under which firms voluntarily disclose all their private information (Beyer et al., 2010). The underlying assumption is that a firm knows its own type, but this type is unknown to external parties.

As discussed in Section 5.1, auditing improves earnings quality and reduces the cost of debt capital. To illustrate the intuition behind the unraveling argument in a voluntary auditing setting, assume that credit risk varies across firms, the firms know their own risk, and that creditors are unable to distinguish between high-risk and low-risk firms when firms are unaudited. If auditing improves earnings quality to the extent making it possible for creditors to differentiate between firms, then all unaudited firms will, in this setting, receive credit on similar terms. To get credit on more favorable terms, firms with below-average credit risk will have an incentive to signal their type by voluntarily hiring an auditor. As a result, the average credit risk of the remaining pool with unaudited firms will be higher than when all firms were unaudited. This will prompt the unaudited firms with the highest quality to audit as well. This will lead to a spiral in which firms choose to be voluntarily audited to separate themselves from lower-quality peers. Eventually, this should result in a market where all but the worst firms choose to be voluntarily audited.

This argument, however, assumes that disclosure is costless (Beyer et al., 2010). As discussed in Section 5.2, audit fees can be significant, especially for small firms. In a market where auditing is costly, firms will only hire an auditor if the benefits of signaling quality exceed the costs. This results in a market equilibrium where only a portion of firms will choose to undergo

auditing.³¹ The analysis of audit mandates from the perspective of signaling theory suggests no inherent need for mandatory auditing, since firms can credibly signal their quality through voluntary audit choices. Moreover, mandatory auditing may even be counterproductive by removing the signaling value of audit choice, thereby suppressing valuable information about the types of firms that would have chosen to be audited (Lennox & Pittman, 2011).

However, the unraveling result rests on several assumptions (see Beyer et al., 2010 pp. 301-305). For example, unraveling will not occur if firms with very good as well as very bad news choose to withhold information (Clinch & Verrecchia, 1997; Fisher & Verrecchia, 2004). In the auditing setting, this situation might occur if poorly performing firms opt out of auditing because they do not want to reveal their financial weaknesses to lenders, while high-performing firms opt out to avoid disclosing sensitive performance information to competitors.

Beyer et al. (2010) identify four main rationales for financial disclosure regulation in the literature: financial externalities, real externalities, agency costs and economies of scale. Of these, the literature addressing real externalities is particularly relevant for the voluntary auditing setting. Real externalities arise when a firm's disclosure affects other firms' decisions and cash flows (Beyer et al., 2010; Dye, 1990). An example of a real externality, that has received considerable attention in analytical and empirical research, is that a firm's disclosure of proprietary information influences a competitor's decision to enter or exit a market (e.g., Cho et al., 2020; Darrough & Stoughton 1990; Ellis et al. 2012; Li et al., 2018, Wagenhofer, 1990). In an auditing setting, this literature raises the question of whether the threat of increased competition deters firms from publishing audited financial statements. Section 5.3 discusses the scant empirical evidence that is available on this topic.

Real externalities also occur when external parties bear the costs of a firm's decision, while the firm exclusively reaps the benefits. For example, opting out of auditing has been associated with higher rates of tax evasion and engagement in illicit activities (Accountancy Europe, 2020). Since society bears the cost of reduced tax income and criminality, such externalities may provide justification for regulation. However, a critical issue is whether the auditor is the party that mitigates these problems most cost-efficiently. An obvious alternative is the imposition of stricter penalties for tax evasion and corporate misconduct. The relative efficacy of auditing and penalties may, in turn, depend on how rational entrepreneurs are in evaluating future legal risks. From the perspective of RQ1, these theoretical insights suggest that mandatory auditing may be justified primarily in settings where externalities or other market imperfections weaken firms' incentives to voluntarily disclose credible financial statements. This point will be explored further in the following section through insights from behavioral economics literature.

4.3. Relaxing the Rationality Assumption

A stream of behavioral economics research in law and economics analyzes how factors such as bounded rationality, bounded willpower, bounded self-interest, over-optimism, and moral

³¹ The signaling literature builds on the assumption that signaling costs vary between firms (see Connelly et al., 2011 for a review of signaling literature). For example, assuming that the benefits of auditing are lower for firms owned by entrepreneurs who are likely to take actions harmful to creditors than for honest entrepreneurs, and that the audit cost is the same for all firms, there may be a signaling equilibrium in which firms owned by honest entrepreneurs choose to be audited, while firms owned by less honest entrepreneurs opt out of auditing. If a separating equilibrium emerges, creditors (and other users of financial statements) can learn about entrepreneurs' traits by observing their auditing choices.

costs influence actors in legal systems (e.g., Garoupa, 2003; Jolls et al., 1998; Sunstein, 1999). Bounded rationality refers to the fact that humans' cognitive abilities are not infinite. To deal with these limitations, people frequently rely on rules of thumb or heuristics. While the rules of thumb are generally useful, they can lead to systematic errors in specific situations (Jolls et al., 1998).

Bounded willpower refers to the tendency of individuals to take actions that they know are in conflict with their long-term welfare. For example, an entrepreneur may recognize that complying with laws and regulations is beneficial in the long run. However, doing so may require short-term sacrifices, such as time or financial resources. When faced with such decisions, entrepreneurs choose the immediate, smaller benefit over the delayed uncertain potentially larger award.³² This preference is explained in the literature on bounded willpower (and lack of self-control) by the concept of present bias, which suggests that individuals disproportionately value immediate outcomes over future ones. In other words, the implied discount rates vary with the time horizon, leading to a strong preference for near-term rewards and an aversion to near-term penalties.³³

We continue with applying the concepts of bounded rationality and bounded willpower to the issue of tax evasion. Tax evasion remains a significant problem in many countries. In the US, for example, Hurst et al. (2014) find that self-employed individuals underreport approximately 25% of their income on average. Using a model based on rationality, firms would trade-off the benefits of tax evasion against its costs (i.e., the risk of being caught and punished) when they decide how much income to report (Allingham & Sandmo, 1972).³⁴ Taxation authorities are responsible for ensuring compliance, and if entrepreneurs running unaudited businesses are, for some reason, more prone to tax evasion than those with audited accounts, taxation authorities can respond by adopting a risk-based strategy and investigate unaudited firms more frequently than audited firms.³⁵ Rational individuals are expected to make at least rough cost-benefit calculations before making their decisions. If the perceived risk of getting caught is sufficiently high, it should deter rational entrepreneurs from engaging in tax evasion. Hence, under the assumption of rationality, the reduced risk of tax evasion alone is arguably not a sufficient rationale for mandatory audits.³⁶

However, the importance of mandatory audits might increase if entrepreneurs behave in boundedly rational ways. Bounded rationality implies that entrepreneurs systematically fail

32 For a comprehensive presentation of the concepts, see for example Jolls et al., (1998), Garoupa (2003), Bukspan (2021) or Dold (2023).

33 This pattern is referred to as "hyperbolic discounting" (e.g., Laibson, 1997).

34 Research concludes that also the tax-morale impacts how much tax that is paid, and that the tax morale varies between individuals and countries (Luttmer & Singhal, 2014).

35 Research suggests that a higher book-tax conformity results in more income decreasing earnings management (Watrin et al., 2014). Therefore, the association between auditing and tax evasion might be stronger in countries with a high book-tax conformity.

36 Similar arguments can be made for other types of crimes related to auditors' responsibilities. The Swedish Economic Crime Authority (2020) finds that criminal activity is more prevalent among firms that choose not to be audited.

to assess costs and benefits accurately. Jolls et al. (1998) suggest that increasing the visibility of law enforcement means the future consequences of illegal actions more cognitively accessible, and lead to more accurate assessments of the likelihood and severity of punishment. They conclude that enhancing the visibility of enforcement is desirable from a prescriptive standpoint. Auditors have regular and frequent contacts with their client-firm and have therefore good opportunities to make the consequences of tax evasion apparent for the firm. Following the reasoning above, improved visibility of enforcement through regular auditor contact could help entrepreneurs more accurately evaluate the risks of non-compliance, thereby reducing the incidence of tax evasion even in the absence of rational behavior.³⁷

Furthermore, mandatory auditing may play a more significant role in reducing tax evasion and corporate criminality if entrepreneurs exhibit risk preferences consistent with bounded willpower. As discussed above, the literature on bounded willpower suggests that individuals display present bias, that is, a strong preference for near-in-time rewards and aversion to near-in-time punishments but that each of these diminish over time. This simplifies that a small penalty near in the future may have a much stronger deterring effect than a large penalty far in the future. As Jolls et al. (1998) point out, potential offenders care much more about the difference between not getting caught and being imprisoned for one year than by the difference between being imprisoned for ten years versus eleven years.

Tax evasion tends to be associated with a relatively low probability of detection and relatively high penalties. One way to increase the likelihood of detection is to require auditors to report such irregularities to tax authorities or other governmental bodies. For example, as mentioned above, in Sweden auditors are required to include an explanatory paragraph in the audit report if a firm has failed to pay taxes, or if it in other ways has violated tax laws.³⁸ In such cases, the auditor must also send the audit report to the tax authorities. Furthermore, Swedish laws oblige auditors to inform the board of directors and the public prosecution service if there are suspicions of criminal activity. Auditors are likely to have a higher probability of detecting such irregularities than tax authorities, and while the consequences of auditors' detection and reporting may be less severe than those imposed by law enforcement, they are more immediate. As such, they may be more effective at deterring entrepreneurs whose time preferences align with bounded willpower. In this way, auditor involvement could serve as a more effective and timely means of deterrence than relying solely on formal legal penalties. Obviously, a policy requiring the auditor to report irregularities works efficiently only if auditing is mandatory.

³⁷ This conclusion parallels the observation by Jolls et al. (1998: 1538) that making parking ticket enforcement more visible by using large visible tickets is more efficient than using small hardly visible tickets because it brings the consequences of a parking offense into mind for those that pass the car with the ticket. Furthermore, Jolls et al. point out that another example of how visibility can impact criminality is that visible police patrols (for example, police that walk in the streets rather than drive patrol cars) can increase the deterrence of potential criminals without altering the actual probability of apprehension. In a similar vein, the visibility about the consequences of tax evasion and crimes brought to entrepreneurs by auditors may deter entrepreneurs from engaging in illegal activities.

³⁸ The Swedish Companies Act (2005:551) (CA) include the following main regulations related to the auditor's responsibilities to report tax evasion and other crimes: Ch. 9 art. 33 CA requires that the audit report should be qualified if board members or the managing director have undertaken actions that may make them liable to pay damages. Ch. 9 art. 34 and art. 37 CA requires that the auditor should include an explanatory paragraph in the audit report if the firms has violated tax laws. The auditor should in that case inform taxation authorities by sending them the audit report. Ch. 9 art. 42-44 CA requires that the auditor should immediately inform the board of directors and the public prosecution service if he or she suspects that some criminal actions have taken place in the company.

Overall, the theoretical literature reviewed in this section suggests that the case for mandatory auditing depends critically on the presence of externalities, market imperfections, or behavioral biases that limit the effectiveness of voluntary auditing mechanisms.

5. A Review of Empirical Literature

In this section, we review empirical studies that explore the economic effects of auditing, structured around two levels of impact: firm-specific and market-wide. This review primarily addresses RQ₂ by identifying the costs and benefits associated with voluntary audits. It also contributes to RQ₁ by examining how mandatory audits affect firms and audit markets. The studies are summarized in Tables 1–4 and discussed in the text to highlight the progress in the area.

5.1. Firm-Specific Benefits

In this subsection, we discuss empirical studies that identify possible benefits of auditing. We focus on studies related to audit exemptions when firms of a certain type (i.e., private firms in the US) or below a given size threshold are allowed to choose to be audited. A firm-level line of reasoning suggests that the credibility of financial information is essential for users, such as creditors and other third-party investors, in making their resource allocation decisions. External auditors provide independent verification that financial information is presented without significant distortion, thereby increasing its reliability (Hope et al., 2011). Audits will thus reduce information risks when capital providers make financial decisions (Hope et al., 2009). Two studies (Dedman & Kausar, 2012; Lennox & Pittman, 2011) examine the impact of audit exemptions on the credibility of financial information measured by firms' credit ratings. Lennox and Pittman (2011) find that when auditing becomes voluntary, the firms that remain audited receive higher credit ratings, while unaudited firms receive lower ratings. They conclude that the rating upgrade is due to the positive impression that the decision to be audited voluntarily conveys to third parties such as credit-rating agencies. Similarly, Dedman and Kausar (2012) find that firms which retained an audit received significantly higher credit scores compared to audit opt-out firms. Both findings suggest that credit rating agencies perceive audited financial statements to be of greater credibility compared to unaudited financial statements. Based on these findings, Peel (2021) examines the conjecture that companies which disclose that their annual accounts are prepared by reporting accountants are rewarded with higher credit scores. He uses a sample of unaudited micro companies from the UK but fails to find any support for his hypothesis.

Furthermore, Dedman and Kausar (2012) and Clatworthy and Peel (2013) investigate the impact of audit exemptions on the quality of financial statements. Dedman and Kausar (2012) find that firms that no longer are audited become less conservative and report more aggressively while Clatworthy and Peel (2013) find that audited accounts are approximately half as likely as unaudited accounts to contain errors. Downing and Langli (2019) examine how audit exemptions affect firms' compliance with relevant accounting and tax regulation. They measure firms' compliance by the "compliance quality score" (CQS), which is constructed using the results of the inspections conducted by the Norwegian Directorate of Taxes. The results show that firms that chose not to be audited had a significantly lower CQS also during the period when they had an auditor. They attribute this result to the difficulty to ensure uniform compli-

ance quality in a mandatory audit regime. Further, they find that the CQS of those firms that chose not to be audited declined after these firms opt out of being audited. These findings suggest that audit exemptions can reduce the quality of financial statements as well as the quality of firms' compliance with accounting and tax regulation for those firms that opt out of audit. Ojala et al. (2020) also explore the conjecture about the credibility of audited financial statements from the tax authority's perspective. They develop a theoretical model and empirically examine whether voluntary audit influences the tax authority's response in terms of tax adjustments, using a large dataset of Finnish small private companies. The result shows the probability of tax adjustments made by the tax authority is lower in companies that choose to voluntary audit and receive an unqualified audit report.

The above evidence indicates greater credibility and quality of audited financial statements. This provides compelling reasons why audited financial information can be important for external capital providers. A significant body of literature investigates this issue focusing on various aspects. Blackwell et al. (1998) use a sample of 212 of U.S. private or closely held firms of which 37% are voluntary audited and find that the choice to be audited leads to significantly lower interest rates. However, they do not find any significant effects of other alternatives to audit, such as review and compilation, on interest rates. Minnis (2011) uses a larger sample with U.S. firms and provide similar evidence on the debt pricing for voluntary audited private firms. He further finds that the cost of debt is more strongly associated with financial statement variables for firms with audited financial statements compared to firms with unaudited financial statements. He concludes that lenders use financial statements to a greater extent in their pricing decisions if they are audited. Kim et al. (2011) also examines how the voluntary choice of audit influences the price of debt using a large sample of Korean private firms. Their finding confirms the results of Blackwell et al. (1998) and Minnis (2011). Allee and Yohn (2009) also consider different types of financial-statement attestations and show that only audited financial statements benefit the firms through greater access to credit. Indeed, some of these studies are based on relatively small samples that reduce the power of the statistical tests. For example, Blackwell et al. (1998) use a sample with 212 firms of which 78 were audited, 34 reviewed and 52 compiled by auditors. Furthermore, various forms of attestations have been aggregated in the analyses. Therefore, we think there is a demand for more research examining how various types of attestations correlate with the availability and cost of debt.

Kausar et al. (2016) further explores the benefits of audit by examining whether the decision to obtain an audit contains information that is independent of the information produced from the audit. Using a natural experiment setting provided by audit regime shift in the U.K., they find that firms that voluntary obtain audit significantly increase their debt, investment, and operating income. They also find that the cost of debt has been reduced for those firms. Kausar et al. (2016) concludes that audits not only enhance financial statement reliability, lowering capital costs, but also offer creditors additional insights, easing financial frictions. Further, they conclude that such information would be hidden by the audit mandate.

The role of credible financial information for external capital providers can depend on country-specific institutional factors. Hope et al. (2011) use survey data from 68 private firms around the world and find that firms whose financial statements were reviewed by an external auditor experience considerably lower external financing constraints. Moreover, they find that this relationship increases in the presence of controlling owners, especially in countries with weaker investor creditor rights. Using survey data, Briozzo and Albanese (2020) study the effects of voluntary audits on firms' investment and financing decisions in countries that are

characterized by a weaker institutional setting (i.e., Argentina, Brazil, Colombia, and Mexico). Their results show that the choice to obtain an audit is positively associated with firms' access to financing and the probability of investing in fixed assets. Their results are consistent with previous findings showing that audited financial statements provide greater financial and investments opportunities, indicating that the audit choice also is important for firms in emerging economies.

In general, the above studies suggest that auditing enhances the quality and credibility of financial information, and access to finance. These findings are directly relevant to RQ2, as they indicate that voluntary audits can generate important firm-level economic benefits.

5.2. Firm-Specific Costs

In this subsection, we seek to add to the literature by outlining potential costs related to auditing by reviewing the relatively sparse empirical literature in the area. The cost of audit includes direct audit fees, and the indirect cost of management time and effort related to the preparation and supervision of the audit process (Bernard et al., 2018; Kausar et al., 2016). Data on audit fees is unavailable in many European countries. Nonetheless, a few studies have estimated average audit fees for private firms. Kausar et al. (2016) report that an average private firm in the U.K. pays audit fees about £6,000, which represents approximately 6% of the firm's earnings. The average audit fees in Spain are approximately €7,000 (Gandía & Huguet, 2018). The indirect cost of management time/effort is difficult to observe. However, Kausar et al. (2016) suggest that these costs are non-trivial.

Further, Kausar et al. (2016) suggest that since audit costs are substantial for small firms, firms near the size thresholds can try to obtain an exemption from the audit requirement by manipulating their size downwards. They examine the frequency distributions of firms along the continuum of size (sales and assets) near the pre-2004 regulatory threshold for audit exemptions in the U.K. and find support for their hypothesis. They attribute the result to the fact that audit represents a considerable cost for small firms.

Bernard et al. (2018) further explore the idea of size management and estimate the costs of disclosure avoidance. Using data on private firms from 12 European countries, they find that approximately 8% of the firms manage their assets to obtain an exemption from the audit requirement. They further report that the estimated direct cost of managing size for firms near the threshold is approximately 7%–9% of the firm's median income. Bernard et al. (2018) conclude that audit represents a substantial cost for small firms despite the potential offsetting benefits. They further discuss that the size threshold creates incentives for firms to be below it.

The above studies suggest that despite potential benefits, audit costs can be substantial, especially for small firms, and may influence firms' incentives to comply with mandates. These findings complement the benefits discussed in Section 5.1 and contribute to RQ2 by highlighting the firm-specific costs associated with auditing.

5.3. Market-Wide Effects of Mandatory Auditing

In this subsection we discuss empirical studies on potential market-wide effects of auditing mandates. Theoretical studies (see the review in Section 4) suggest that firm disclosures also affect other firms and result in information spillovers and externalities. There is a growing stream of recent research that addresses this issue.

Breuer (2021) explores the effects of mandatory reporting and auditing on industry-wide resource allocation using data from 26 European countries. The result in his study suggests that audit mandates make entry for small firms more difficult and that it increases the minimum level of productivity required for firms to operate in an industry. Breuer concludes that auditing mandates do not lead to improvements beyond firms' voluntary audit choices and that they impose a fixed cost on firms.

In a recent study, Breuer et al. (2023) develop a theoretical model (described in Section 4.1) and empirically examine whether mandatory auditing influences the audit market using data on European firms. In their empirical analyses, they find that audit mandates considerably increase audit demand, while simultaneously decreasing the average size of audit firms' clients. Small firms mandated to buy an audit tend to buy a cheaper audit in a differentiated audit market to keep their costs down. As a result, this mainly increases the demand for lower-quality audits. Further, they report that an audit mandate is associated with a significantly lower average auditor wage, which is explained by younger unexperienced auditors entering the market. At the same time, they observe that audit mandates displace the rate of voluntary audits among other firms. The explanation they provide is that audit mandates increase audit cost (due to limited audit resources) and thereby impose economic externalities on other firms. Breuer et al. therefore question the effectiveness of audit mandates due to the emergence of low-quality audits.

These findings suggest that mandatory auditing may have broader market-wide consequences that extend beyond individual firms. From the perspective of RQ1, this highlights how audit mandates can influence audit market structure, entry conditions, and firms' incentives to obtain voluntary audits.

5.4. Other Studies on Effects of Audit Mandates

In a recent study, Dong et al. (2023) uses Swedish data and explore the prediction that the shift to a voluntary audit regime will induce greater levels of tax avoidance for firms that voluntarily choose to retain audit compared to firms that are under an audit mandate. The results support this prediction, and they find that firms with voluntary audits significantly decrease their tax burden relative to firms with mandatory audits. This change in tax burden is equivalent to about 1,500 EUR or 19% lower tax payment for each firm with a voluntary audit. Their results also suggest that the voluntarily audited firms report higher levels of tax avoidance if their auditor's client portfolio size is composed by more than 50% of firms that voluntarily choose to be audited. They conclude that a voluntary audit regime weakens auditor independence which results in higher levels of tax avoidance.

These findings suggest that the effects of audit mandates may depend on how regulatory regimes influence auditor incentives and independence. From the perspective of RQ1, this highlights the importance of institutional design when evaluating the potential benefits of mandatory auditing. Overall, the empirical literature reviewed in this section suggests that auditing can generate important firm-level benefits, such as improved financial statement credibility and lower financing costs, while also imposing non-trivial costs, particularly for smaller firms. These findings provide insights into RQ2 by highlighting the trade-offs firms face when deciding whether to obtain an audit voluntarily. At the same time, the evidence on market-wide effects contributes to RQ1 by illustrating how audit mandates can influence audit markets and the behavior of other firms.

6. Conclusions and Suggestions for Future Research

Audit mandates of privately held firms vary significantly across the world. At the one extreme, Nordic countries exempt only micro firms from audit requirements, while at the other extreme, countries like the US and Canada exempt most privately held companies from statutory audits. Under the current EU Accounting Directive, mandatory auditing is only required for companies that exceed certain thresholds. However, Member States are allowed to impose audit requirements on smaller companies whose sizes fall below the thresholds. However, individual EU countries have the discretion to apply stricter national rules and set lower thresholds, thereby extending audit requirements to smaller entities. This paper presents a synthesis of theoretical arguments and empirical evidence on the justification and effects of mandatory auditing for small, privately held firms. In doing so, the review addresses three research questions concerning the motivations for mandatory auditing (RQ 1), the firm-level costs and benefits of voluntary audits (RQ 2), and the research gaps in the literature on mandatory auditing (RQ 3).

This review has examined the literature on both the firm-level costs and benefits of auditing and the broader theoretical arguments for audit mandates. Many empirical studies support the view that auditing enhances the credibility of financial reporting. While findings are somewhat mixed, most studies indicate that audited financial statements are associated with higher credit ratings, lower borrowing costs, fewer accounting errors, improved access to external financing, and better compliance with accounting and tax regulations. However, these benefits alone do not provide sufficient justification for making audits mandatory. In the absence of externalities (i.e., situations where the costs or benefits of auditing extend beyond the individual firm), firms already have incentives to voluntarily obtain an audit when the expected benefits outweigh the costs.

With respect to RQ 1, the theoretical literature suggests that externalities may, in certain cases, justify audit mandates. For example, disclosure literature identifies the effects on competition as an externality that influences firms' willingness to disclose financial information. Hypothetically, the higher-quality financial reports of audited firms could provide competitors with better insights into the profitability in the industry and thereby influence competition. The threat of competition might deter some firms from voluntarily disclosing such information. This could result in fewer audits being undertaken than what would be socially optimal. There is, therefore, a need for further empirical research on how such disclosure externalities impact firms' audit choices.

With respect to RQ 2, our review indicates that voluntary auditing often provides substantial private benefits. With respect to RQ 3, our review also highlights several important gaps in the existing literature. One area deserving particular attention is the potential role of auditing in reducing tax evasion and financial misconduct. Our review of mandatory auditing requirements in selected EU countries indicates that policymakers in, for example, Denmark and Sweden, view auditing as a tool to mitigate these problems. In Denmark, small firms that have violated accounting or tax laws may be required to undergo a mandatory audit for a period of three years. In Sweden, auditors are obligated to report suspected tax violations to the relevant authorities. These rules reflect the perception of the auditor as a compliance mechanism that increases regulatory visibility. Since the costs of tax evasion and financial crime are borne by society at large, such violations represent externalities that may motivate regulatory intervention. However, a key question is whether auditors are the most cost-effective mechanism to address these issues. An alternative could be stronger enforcement through severe penalties for non-compliance.

Virtually all of the extant mandatory auditing literature assumes that entrepreneurs are fully rational. However, the insights from behavioral economics challenge this assumption. Entrepreneurs running small businesses may exhibit bounded rationality or bounded will-power, underestimating future compliance risks or overvaluing short-term costs and benefits. We suggest that auditing might play a greater role in reducing tax evasion and criminality if one acknowledges that small business entrepreneurs do not always act in a fully rational manner. Therefore, we encourage more research on the relationship between audit mandates, entrepreneurial behavior, tax evasion, and corporate misconduct.

As noted, some EU countries have implemented unique approaches to reduce tax evasion and criminality. However, the effectiveness of these policies remains largely untested. For example, does the Danish rule to impose mandatory auditing for firms that have violated tax or accounting laws reduce tax evasion or financial misconduct? Does the Swedish requirement that auditors report legal violations to the authorities improve compliance? Or does the German practice of using a tax advisor (*Steuerberater*) (who is responsible for preparing tax declarations and annual reports) result in lower tax evasion and higher reporting quality? We encourage future empirical research to examine the effects of such idiosyncrasies in the legislation. That research could be done as cross-country studies or as longitudinal studies that assess the impact of regulatory changes within a country over time.

In conclusion, the literature reviewed in this paper suggests that the justification for mandatory auditing (RQ 1) depends on the presence of externalities or enforcement concerns, while the evidence on firm-level costs and benefits (RQ 2) indicates that voluntary auditing often provides substantial private benefits. However, we identify no empirical or analytical studies that justify a general policy of mandatory auditing for all small private firms. Therefore, based on the current body of literature, we conclude that the arguments in favor of audit mandates remain weak. However, the presence of underexplored externalities, the limitations of rational behavior assumptions, and the diversity of regulatory practices all point to the need for more focused empirical research. Future studies could explore how audit mandates perform in different institutional environments, evaluate the effectiveness of alternative policy tools aimed at improving compliance and financial reporting quality, and assess their behavioral impacts in the private sector.

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Table 1. Analytical studies of issues directly or indirectly related to audit mandates

AUTHOR (YEAR)	RESEARCH QUESTION	FINDINGS
Breuer <i>et al.</i> (2023)	How audit mandates shape audit markets (theoretically and empirically)	Audit mandates do not ensure regulatory compliance and may result in low-quality audits.
Ronnen (1996)	Effects of mandatory and voluntary audits on audit quality	Auditing mandates widen the disparity in quality between audit firms

Table 2. Studies on the association between mandatory auditing and firm-specific benefits

AUTHOR (YEAR)	RESEARCH QUESTION	SAMPLE	FINDINGS
Blackwell <i>et al.</i> (1998)	The paper examines the relationship between services provided by independent auditors and firms' interest rates	USA: 212 private or closely held firms from the year 1988 (37% -voluntary audit, 16% -review, 24% -compilation, and 23% -no auditor association)	Companies that undergo audits enjoy significantly reduced interest rates compared to companies that don't undergo audits, and this advantage diminishes in a non-linear manner as the size of the company grows. Other types of assurance services are not significantly related to interest rates
Chung and Narasimhan (2001)	Following the elimination of the statutory audit of small private companies in the UK in 1994, this research assesses the perceived value of audits for small firms in Hong Kong where no-audit options are not available for private firms	Hong Kong: 44 small private firms (mandatory audited) and 41 small audit firms	Both groups of respondents do not support the idea of eliminating the compulsory annual audit for small private firms in Hong Kong. Despite the expenses involved, both groups believe that the benefits derived from audits outweigh the costs
Allee and Yohn (2009)	Among other things, this study explores whether firms with financial statements, firms with audited financial statements, and firms with accrual-based financial statements experience advantages such as increased access to credit or reduced borrowing costs	USA: 4,004 firms for 2003 and 2004, of which 790 produced financial statements. Of the 790 firms with financial statements, 496 firms have received any form of audit assurance (43% -voluntary audit, 33% - review, 24% -compilation)	Firms with audited financial statements have a greater access to credit and firms with accrual-based financial statements pay significantly lower interest rates
Hope <i>et al.</i> (2011)	The paper examines the association between the firms' choice to have an external auditor and their perceived external financing constraints (i.e., access to financing and cost of financing)	International: 68 countries: 30,871 observations (29,829 unique firms) between 2002-2005	The result demonstrates that audited firms face lower perceived constraints when it comes to obtaining financing. The result is particularly prominent in firms that have a controlling shareholder and operate in countries with weaker institutions.
Kim <i>et al.</i> (2011)	The paper investigates the association between voluntary audited private firms and debt pricing	Korea: firm-year 72,577 observations from 1987 to 2002, of which 4% have voluntary audits	Private firms with voluntary audits pay significantly lower interest rates on their debt than unaudited firms
Lennox and Pittman (2011)	Examines whether voluntary choice of audit conveys valuable information about the company type	USA: 5,139 private firms are analyzed during the mandatory (2003) and voluntary (2004) audit regimes. Of those firms 33% choose to become unaudited year 2004	The companies that remain audited receive credit rating upgrades because they send a positive signal to lenders and investors
Minnis (2011)	Investigates the association between verification of financial statements and debt pricing	USA: 25,784 firm-year observations from 2001 to 2007 (23% -voluntary audit, 45% -review, 32% -compilation)	Companies with audited financial statements experience a notable reduction in their cost of debt and the information derived from audited financial statements is more strongly correlated with interest rates

Dedman and Kausar (2012)	This study investigates how credit scores, and financial reporting quality of private firms are associated with the voluntary choice of audit	UK: 4,873 firms for 2003 and 2004, of which 72% retain voluntary audit 2004 (the first year in which they were exempt)	Firms retaining a voluntary audit are associated with more conservative financial reporting and receive higher average credit scores despite their lower average profits
Carey <i>et al.</i> , (2013)	The study outlines the federal laws requiring the auditing of for-profit private and not-for profit companies in Australia and discuss the firm-level costs and benefits associated with mandatory auditing	Australia: 21,711 companies (whole population)	The costs are estimated to be substantial. The potential benefits include the credibility of information, positive influence on the culture, governance, and quality of firm management
Clatworthy and Peel (2013)	This study examines the effects of voluntary audit on the probability of errors occurring in published financial statements	UK: 1,067,577 small firms (one year's data for each firm) of which 1.3% are voluntary audited	Firms that opt out an audit are approximately twice as likely to submit defective annual accounts compared to the firms that choose to be audited
Kausar <i>et al.</i> (2016)	This study examines whether the decision to obtain an audit reduces financial constraints for firms and contributes to more efficient investments and improved firm performance	UK: 24,156 firm-year observations from 2001 to 2006 (include treatment and control samples of different sizes)	Firms with voluntary audits experience significant increase in their levels of debt, investments, and operating income. In addition, they pay lower interest on debt
Downing and Langli (2019)	The study examines the effect of mandatory auditing on firms' compliance with accounting and tax regulation	Norway: 6,686 firm-year observations from 2009 to 2012	Audited firms have significantly higher "compliance quality score" (CQS) compared to opt-out firms. Also, among opt-out firms: 1) CQS declines considerably after these firms opt out of auditing; 2) the decline of CQS is primarily observed in firms that in addition to opting out, also decided to discontinue using an external consultant for the preparation of their annual financial statements
Briozzo and Albanese (2020)	The paper examines how voluntary audits influence the probability of debt financing from financial institutions, trade credit from their suppliers and the amount of investments in fixed assets	International: 148 countries: 1,803 firms for 2010	Voluntary auditing has significantly positive effect on the probability of bank financing, fixed assets investment, and the percentage of working capital financed with suppliers
Ojala <i>et al.</i> (2020)	This research investigates how tax aggressiveness (tax return) and the voluntary audit of financial statements influence the probability of tax adjustments in small private companies	Finland: 19,527 firms for 2010	A voluntary audit, coupled with an unqualified audit opinion moderates the relationship between tax aggressiveness and the likelihood of tax adjustments
Peel (2021)	This paper examines the effects of filing micro accounts and the appointment of a reporting accountant on credit scores	UK: 13,102 firms, various years up until 2015	Filing of micro-entity abbreviated accounts results in lower credit scores. The hiring of a reporting accountant has no effect on credit scores

Table 2. Studies on the association between mandatory auditing and firm-specific costs

REFERENCES	RESEARCH QUESTION	SAMPLE	FINDINGS
Kausar <i>et al.</i> (2016)	Has been described above		The finding indicates that companies strategically adjust their size to meet the requirements for audit exemption
Bernard <i>et al.</i> (2018)	The study investigates whether private firms manage their size to avoid additional public disclosure or mandatory auditing	International: 12 European countries: 503,666 observations from 2003 to 2011	Firms intentionally reduce their size when approaching specific bright-line size thresholds that mandate increased disclosure as well as external audit requirements

Table 3. Studies on market-wide effects of mandatory auditing

REFERENCES	RESEARCH QUESTION	SAMPLE	FINDINGS
Breuer (2021).	Examines the effects of reporting and auditing mandates on the concentration of ownership, the concentration of market share, and business dynamism (entry and exit rates)	International: 26 European countries: 223,924 observations from 2000 to 2014	Reporting mandates promote the dispersion of ownership in capital markets and encourage competition in product markets. Auditing mandates are associated with decreased entry rates and increased minimum required level of productivity to operate
Breuer <i>et al.</i> (2023)	This study examines the impact of audit mandates on the main players of the audit market: firms purchasing audits, audit firms and auditors	International: 24 European countries: 100 largest audit firms from each country from 2003 to 2019	Audit mandates lead to an increased demand for audits and larger audit firms, while simultaneously reducing the average size of clients served by audit firms. Additionally, audit mandates result in an increase in the number of auditors in the market, but a decrease in their average wages

Table 4. Studies on other effects of audit mandates

REFERENCES	RESEARCH QUESTION	SAMPLE	FINDINGS
Dong <i>et al.</i> (2023)	This study investigates the potential correlation between audit status (voluntary or mandatory) and the tax avoidance practices of private firms	Sweden: 43,326 firm-year observations (matched sample of 50% voluntary and 50% mandatory audits) from 2006 to 2014	Firms demonstrate increased levels of corporate tax avoidance when operating under a voluntary audit regime. This effect is partially attributed to a decrease in auditor independence



Lahjoittaminen on tulevaisuuteen sijoittamista – Liikesivistysrahasto tukee apurahoin liikkeenjohtoa palvelevaa tutkimusta, koulutusta ja julkaisutoimintaa.

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The Nordic Journal of Business is a scholarly journal that publishes original scientific research in all fields of business studies. Different aspects of business theory and practice related, among others, to accounting, corporate governance, entrepreneurship, finance, information systems, international business, management, and marketing are within the scope of the Journal.

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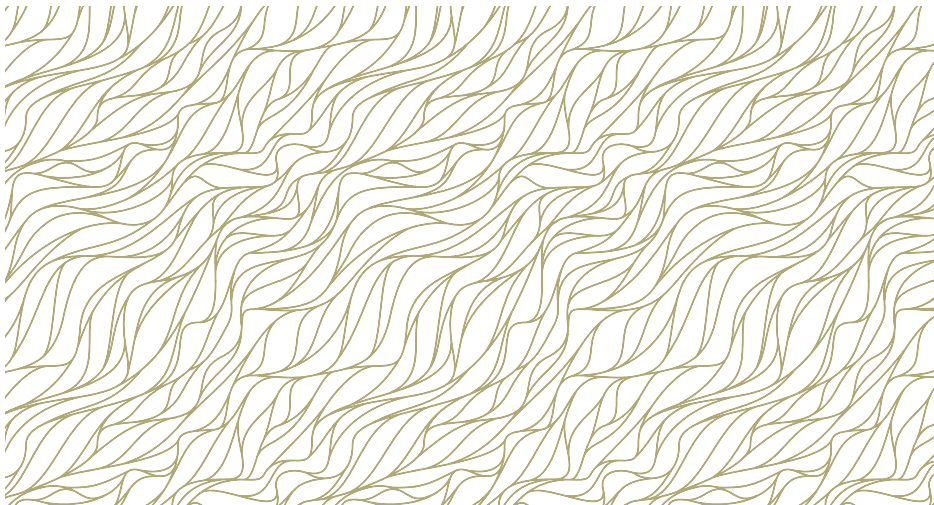
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 Last name of the author, first name(s) or initials (year of publication). *Title of the book*. Edition. Publisher. Wooldridge, J.M. (2010). *Econometric Analysis of Cross Section and Panel Data*. 2nd Edition. The MIT Press. ISSN 2342-9003 (print), ISSN 2342-9011 (online)

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Editorial correspondence: The Association of Business Schools Finland, Mr. Juuso Leivonen, Pohjoinen Makasiinikatu 7 A 2 00130 Helsinki, Finland.

E-mail: editor@njb.fi
http://www.njb.fi