

Evaluating Auditor's Materiality Judgements of Audit Firms in Bangladesh

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Abstract: This paper investigates materiality determination practices in ten audit firms in Bangladesh and explores the influence of financial statement users' information needs on auditors' decisions in regard to materiality judgements. To test audit materiality guidance, data were gathered through interviews with 10 senior auditors of the selected audit firms in Bangladesh and to assess the impact of information needs on auditor's materiality judgment, data were obtained from 100 practicing auditors through an online survey utilizing a structured questionnaire. The data collection employed a random sampling approach, and the analysis of the data was conducted using structural equation models. Findings indicate consistency in setting quantitative guidelines for net profit, total assets, total turnover or sales for determining the overall materiality level, percentage setting for overall materiality, tolerable misstatements, trivial misstatements, identified and undetected misstatements, and a significant impact of user information needs on auditors' judgments. The study offers valuable insights for accounting students, professionals, and standard setters, shedding light on practical application of materiality and its relation to user requirements, thus contributing new perspectives to the existing literature.

Keywords: Materiality, Misstatements, Information needs, Audit firms, Overall materiality.

1. Introduction

In the context of auditing, materiality states the relative impact or importance of an item in the financial statements, considering its nature and amount. Determining materiality is crucial for auditors as it guides them in executing the audit procedures. Materiality is a serious issue for international accounting and auditing Standard setting bodies, regulatory bodies, investors, auditors, managers and creditors. The International Auditing and Assurance Standards Board (IAASB) issued the materiality standard to be followed by auditors across the world. Audit firms apply materiality guidance in conducting the audit. As the internal and external users' economic decision of investment rely upon the material information of the company, audit materiality guidance is vital for proper materiality judgement. The

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integration of materiality guidance in firms' methodology is crucial for various stakeholders in the fields of accounting and auditing (Eilifsen and Messier, 2015). Due to collapse of prominent corporations worldwide over the last decade, the audit standards are reforming day by day which make the standards more principle-based and less prescriptive; resulting in shifting towards greater reliance on professional judgment throughout audit engagements (Hasan, 2023). Entities are required to exercise materiality judgments when making decisions regarding recognition, measurement, presentation, and disclosure (IFRS foundation, 2017). There are many factors that affect auditors' materiality judgements. The auditor's determination of materiality is a matter of professional judgment and is influenced by the auditor's perception of the financial information requirements of users of the financial statements (Eilifsen and Messier, 2015). Besides, auditor's ethical judgment is also affected by materiality (Nurin & Chaity, 2020). In an environment where some regulators demand materiality disclosures based on investors' majority requests, while others delay such requirements pending further consideration, academic research in this domain becomes crucial (Christensen et al., 2018). Thus, there is growing necessity to research more on the materiality practice across the audit firms along with influence of information requirements of financial statement users on the materiality judgements. In Bangladesh, scarce efforts are given on the materiality judgements along with the auditors' consideration of stakeholders' information demands. Therefore, the motto of this study is to know how audit firms in Bangladesh are applying their materiality guidance and whether their materiality considerations are affected by the diverse information needs of different users. Such research can offer valuable insights to regulators, auditors, audit firms and their clients in Bangladesh grappling with the complexities of materiality determination and its disclosure requirements by considering the information necessities of user's, aiding in informed decision-making processes and contribute to advancing our understanding of materiality concepts in auditing theory and practice. Consequently, we propose the following research framework to extend the objective of this research (see figure 1).

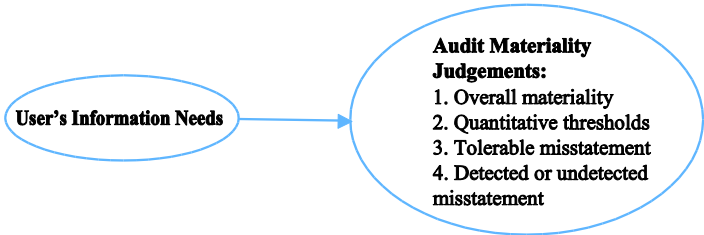


Figure 1: Research framework

The remaining of the study covers the following parts. In the subsequent section, our study offers reviews of previous research works followed by a concise summary of the existing standards on materiality, and outline the research queries. We then detail the methods employed, succeeded by a section that reveals the outcomes. The final segment delves into the findings and their implications, offering concluding remarks.

2. Review of Literature and Hypothesis Development

Several prior studies examined the materiality concept from different viewpoints:

Messier et al. (2005) performed review analysis concerning materiality issues since the period of 1982 being driven by worries of International Accounting and Auditing Standard Board, and Regulatory agencies on substantial corporate breakdowns resulted from improper auditing. Messier et al. (2005) recommended further investigations in the field of materiality planning, assessing materiality considerations, evaluating materiality decisions, characteristics of the items checked, significance of shortcomings in an organization's internal controls, multilocational audits. Later on, Chen et al. (2008), Blokdijsk et al. (2003), Pinsker et al. (2009), Chandra and Calderon (2008), and Dez Oort et al. (2003) covered most of these areas.

Messier et al. (2005), Acito et al. (2009), Keune and Johnstone (2009) examined the qualitative benchmarks and quantitative guidelines on materiality in respect to detected misstatements. Acito et al. (2009) evidenced that auditors find variation across the firms in using both qualitative and quantitative considerations in correcting the prior year errors, but the management and auditors are not willing to disclose immaterial items to outsiders. Due to lack of disclosure of such unobservable item amount, stakeholders don't get the complete view of the nature uncovered errors, nature of the business. The lack of transparency in reporting prevents the correction of mistakes in the business, leading to discrepancies in the application of quantitative thresholds across audit firms. This unwillingness results in opportunity for researchers to estimate unpublished or uncovered immaterial misstatements.

Lakshan et al. (2020) found that despite the significance, anticipated by International Integrated Reporting Council, of materiality of nonfinancial information on enhancing reporting quality and users' decision making, difficulty of quantifying nonfinancial information makes the materiality

determination challenging. The necessity of identifying various user groups with their information needs is advocated while materiality is determined.

Houghton et al. (2011) examined the real expectations gap of investors and found that investors are not well understood about the concepts used in the materiality. Investors pointed out the difficulty of disclosing the meaning of materiality in the easy way (layman terms) and expressed their feeling that publishing the actual level of tolerable errors might be harmful.

Baldauf et al. (2015) have come with conclusion that audit risk assessment has strong influence on planning materiality assessment, and the implementation of standardized quantitative guidelines doesn't result in wide changes in auditor's materiality assessment. They focused on the auditor's individual judgement in finding the material misstatements instead of emphasizing on quantitative guidelines.

Christensen et al. (2020) examined the impact of materiality disclosure on investment decision of investors and found that materiality disclosures are not properly grasped by financial professionals. They don't understand the materiality disclosure in the way auditors intend to mean the materiality.

Al Mamun (2018) insisted on disclosure of non-financial information in sustainable reporting while environmental, social and economic issues are considered in the context of sustainability.

Tušek and Ježovita (2020) evidenced no notable distinctions between the audit firms of large and small size on disclosing material information.

Uncovering the major material matters, both in qualitative and quantitative terms, has become the serious problem in sustainable corporate financial reporting as business leaders consider the magnitude of impact of material items to judge the ability of the business in value creation over time (Ngu & Amran, 2021). They argued on stakeholder engagement and support of board of directors in regard to materiality to be considered as crucial step in ensuring the sustainability reporting.

Eilifsen and Messier (2018) found the consistency across the major audit firms in USA in using materiality guidance in respect to quantitative as well as qualitative benchmarks used to determine the materiality thresholds. Acito et al. (2009) evidenced variation across the firms in using this guidance. Thus, the way in which materiality guidance is intricated in firms' methodology is significant to accounting and auditing researchers, practitioners, regulators and educators (Eilifsen and Messier, 2018).

Sulaiman et al. (2023) investigated the understanding and application of materiality among financial statement preparers and auditors in Malaysia, with a focus on the usefulness of International Financial Reporting Standards (IFRS) guidance, particularly IFRS Practice Statement 2: Making Materiality Judgements (PS2). Through interviews with 15 financial statement preparers and 20 external auditors, the researchers gathered insights and experiences on the application of materiality in financial reporting and auditing. Findings indicate that the IFRS guidance, including PS2, has been beneficial for both preparers and auditors. Specifically, it has facilitated the consideration and balancing of both quantitative and qualitative factors when determining the materiality of information.

Dwyer et al. (2023) investigated how auditors disclose materiality threshold information in UK audit reports following the Financial Reporting Council's (FRC) introduction of expanded audit reports. Through manual content analysis, the research examines auditors' benchmarks, the percentages applied to those benchmarks, and their use of non-GAAP benchmarks, along with the rationales behind their choices. Findings reveal a wide variety of benchmarks used by auditors, along with a broad range of percentages applied. Non-GAAP adjustments are common, with rationales including the benchmark's role as a financial statement performance measure and its ability to reduce volatility.

Ma et al. (2023) examined how the disclosure of Key Audit Matters (KAMs) and management's related footnote disclosures regarding subjective accounting estimates, particularly fair value, influences auditors' perceptions of accountability and subsequent adjustment decisions. It reveals a substitution effect between KAMs disclosures and footnotes: auditors feel less accountable when fair value estimates are included in either KAMs disclosures or expanded footnotes provided by management. Overall, the findings demonstrate that the requirement to disclose KAMs significantly impacts auditors' perceptions and interacts with management's disclosures to influence adjustment decisions.

Quick et al. (2023) found that auditors generally comply with regulations and aim to bridge the information gap by providing additional disclosures while auditors apply materiality in their reports following the implementation of the revised standard on auditors' reports in the UK. However, there are inconsistencies in the type and extent of disclosures, possibly due to concerns about revealing the subjective nature of auditing, which could potentially diminish the usefulness of the reports. While the revised standard has

increased transparency, there is still room for improving the meaningfulness of disclosures in auditors' reports.

Kend and Nguyen (2023) delved into the divergent practices of audit materiality disclosures among external auditors in Australia and New Zealand, particularly focusing on PwC's introduction of innovative practices in this regard. The research explores the underlying reasons behind the adoption or rejection of PwC's voluntary disclosure policy by other audit firms, shedding light on the interplay between competing institutional logics. Findings reveal that in New Zealand, both Deloitte and KPMG have succumbed to stakeholder pressure and adopted PwC's voluntary disclosure practice, whereas resistance is observed in Australia. The study also examines the perceived risks associated with these differing audit disclosure practices. Ultimately, it illustrates how the dissemination of ideas in the audit domain is influenced by a pursuit for tangibility, mediated by the interplay between institutional logics, resulting in contrasting audit disclosure practices between Australia and New Zealand.

Alardi et al. (2022) concluded that problems with applying materiality and preparers' fear of accountability often result in over-disclosure of information to meet all standards' requirements, exacerbating the issue of excessive disclosure.

Implementing materiality assessment enhances the quality of data presented in the audited financial statements that directly benefits the reasonable user's economic decision. If the auditors, regulatory bodies like ICAB, BSEC can ensure proper materiality guidance it will help the companies in disclosing high quality material financial and nonfinancial information that result in improved investment decision of investors. Atuilik and Salia (2018) argued that accurate, timely and high-quality financial reporting contributes significantly to the development capital markets in developing countries. Therefore, materiality implementation ultimately contributes to the economic development of Bangladesh.

While studies have examined auditors' and preparers' perspectives on materiality, there is limited research on the views of financial statements users and other stakeholders, such as investors, regulators, and financial analysts. Investigating stakeholders' perceptions and their information expectations regarding materiality could provide a more comprehensive understanding of its significance in financial reporting. Besides, the existing archival and behavioral studies presents the concept of materiality from other

countries highlighting the scarcity of research efforts on examining how the audit firms in Bangladesh really implement the materiality benchmarks and whether the information prerequisites of different users' group do actually matter in deciding on materiality issues. So, we attempt to examine the practice of audit materiality guidance along with the influence of information needs on auditor's materiality decisions of audit firms in Bangladesh. That is, the study identifies the materiality guidance practices in audit firms in Bangladesh, information needs of audited financial statement users, materiality percentage determination procedure, way of handling detected and undetected misstatements in Bangladesh.

Materiality evaluations of auditors are notably affected by the information demands of stakeholders and stockholders who equitably estimate getting clear insights into the business activities and economic consequences. As the management appoints the company's auditors to present a true and equitable views of all the transactions of the organization so as to maintain the interest of the owners and other stakeholders, auditors must weigh information rewire by the shareholders and other related parties. Auditors are appointed by the management of the company to show the interest of the shareholders and other stakeholders, and to review and analyse the information included in the financial statements diligently, they must consider the information needs of investors. Additionally, auditors generally adhere to regulatory requirements regarding materiality disclosures, ensuring that the information provided in audit reports aligns with established standards. Earlier studies such as Eilifsen and Messier (2018) and Quick et al. (2023) have shown that there is consistency in practicing materiality judgements across the various audit firms.

Based on above discussions, we can develop the following hypothesis:

Hypothesis 1: There is consistency in applying materiality guidance across various practicing audit firms in Bangladesh.

Hypothesis 2: Information needs of different users' group positively influence the auditor's materiality judgement.

2.1 Research questions

To reduce the gap in the literatures identified above, our study focus on the following research questions:

1. How do the audit firms in Bangladesh implement audit materiality guidance?

2. Does the information required by the owners and other stakeholders really matter in evaluating auditor's materiality decisions?

2.2 Objectives of the study

To verify the hypotheses and to answer the aforementioned research questions, this study aims to

- i) know the practice of audit materiality guidance across different audit firms in Bangladesh.
- ii) show the impact of user's information demands on determining the auditors' materiality judgements in Bangladesh.

3. Synopsis of Standards on Audit Materiality

The International Auditing and Assurance Standards Board (IAASB), U.S. Auditing Standards Board (ASB), and Public Company Accounting Oversight Board (PCAOB), Professional initiatives, such as the Big Five Audit Materiality Task Force in 1998, and regulatory bodies such as the Securities and Exchange Commission (SEC) have developed various standards and rules regarding materiality issues in response to demands of different stakeholders. These standards expand requirements for auditors to consider users' information demands on audited financial statements, offer more comprehensive directions on fixing diverse magnitude of materiality, guidance on evaluating misstatements, introduce a more comprehensive approach to evaluating misstatements by explicitly considering the effect of undetected misstatements. Practically, audit firms' materiality implementations are governed by the relevant audit materiality standards. We provide brief discussion regarding materiality issues on determining overall materiality, tolerable misstatements, identified and unidentified misstatements in the context of applicable auditing standards.

3.1 Determination of overall materiality

The determination of overall materiality in auditing involves establishing a threshold for overall financial statements. Auditing standards, including guidance from the Public Company Accounting Oversight Board (PCAOB) and the Auditing Standards Board (ASB), offer a structure for auditors to establish overall materiality. Here is a summary of the key points mentioned in the provided text:

3.1.1 PCAOB guidance

The PCAOB's standard suggests that auditors should assess the earnings and other applicable factors of the company while establishing overall materiality. However, it does not provide specific percentages to be used to these proportions.

3.1.2 ASB guidance

The ASB, in contrast, offers more specific benchmarks for determining overall materiality. Based on the entity's situations, these standards involve areas such as income before taxes, total sales revenues, gross margin, total equity, or net asset. The choice of benchmark depends on factors like the company's nature and volatility of profit before tax.

3.1.3 Percentage application

Notably, neither set of standards provides explicit amounts to be utilised to the pertinent benchmarks. The evaluation of overall threshold level as materiality depends upon auditor's judgements, considering the particular situation of the entity being audited.

3.1.4 Revaluation of overall materiality

Auditing standards emphasize the importance of reevaluating the predetermined standard of overall materiality as the audit precedes. When new insights or information is noticed by the auditor at the time of audit that may result in varied initial ascertainment of overall materiality, he/she is required to reassess and potentially adjust the overall materiality level.

In this way, the process of determining overall materiality involves considering various benchmarks, with the ASB providing more specific categories. Auditors are given flexibility to use judgment in selecting benchmarks and methods, and they are required to reevaluate overall materiality throughout the audit based on new information and changes in circumstances.

3.2 The tolerable misstatement

The guidance from AS11 (PCAOB 2010a) provides directions on ascertaining acceptable level of misstatement in the audit process on the following areas:

3.2.1 Fixing materiality levels for specific accounts or disclosures

The auditor requires to assess if particular accounts or disclosures, even if the misstatements are smaller than the overall materiality level established for

the financial statements, could have a considerable bearing on the decision of a rational investor. If such records or reporting are found, a distinct materiality amount should be established by the auditor. This allows for tailored planning of audit process specific to those accounting records or disclosures.

3.2.2 Fixing tolerable or acceptable misstatement

It is required to fix up the quantitate level for acceptable misstatements to evaluate the materiality risks concerning the misstatements, plan and implement the audit process for the records or disclosures level. Such acceptable misstatement should be determined at amounts that reduce the possibility that the gross amount of undiscovered and uncorrected misstatements would equal to a material misstatement of the financial statements. Such misstatement ought to be lower than the materiality threshold set for the financial statements collectively and, if applicable, smaller than the materiality amounts set for specific account balances or transactions.

4. Research Methodology

4.1 Data and procedure

The study is conducted with the aim of testing the materiality guidance of audit firms in Bangladesh and test whether the information demands of user groups influence the materiality judgement of auditors. To know materiality practices, we have selected ten audit firms in Bangladesh randomly to test their materiality guidelines. We have contacted with the auditors who held the senior position of the firm to collect materiality guidance of the firms and conducted a comprehensive interview concerning the materiality aspects. We have provided nondisclosure oral assurance with the firms to maintain secrecy of firms' guidance.

We have followed the procedures used by Eilifsen and Messier (2015) that verified the audit materiality guidance of major public firms. Similar process was also applied by Epps and Messier (2007) to examine materiality guidance of the major audit firms.

This study is largely based on primary data. We have requested the auditors to obtain their materiality guidance and discuss with them that we will follow the research process followed by Eilifsen and Messier (2015). But they failed to provide any written guidance and said that they follow the ISA 320 for performing audit materiality judgements. The data collection period for this

study spanned five months, from March 2023 to July 2023. The collection process involved multiple phases: initially, materiality standards was obtained from ten randomly selected audit firms in Bangladesh, and interviews were conducted with senior auditors during the period from March to April 2023. This timeframe allowed for thorough and comprehensive data collection while accommodating the availability of auditors. Subsequently, survey data collection took place over a three-month period, from May to July 2023. This requires extended time as the respondents for the survey were reached through various channels, including ex-students, classmates, and departmental seniors and juniors who are currently practicing in audit firms.

To show the impact of users' information needs on the materiality judgements we randomly selected 100 practicing auditors. The survey data are collected through structured quesnaire involving five-point Likert scale where, 1= Strongly Disagree, 2=Disagree, 3=Neither agree nor disagree, 4= Agree, 5= Strongly Agree, from auditors of the company. The questionnaires were delivered to the respondents using the online media. All items of the user's information needs and auditor's materiality judgements were selected based on the reviews of related literature. The items of the quesnaire are described in the Appendix 1.

4.2 Data analysis procedure

The descriptive analysis was performed for measuring the firm's materiality practices. The analysis of survey data was completed through the Structural Equation Modeling (SEM) approach which was done by using SMART-PLS software version 3.00.

5. Analysis and Results

5.1 Analysis of interview questions for assessing materiality guidance

Question 1

What standards do you follow for Determining Overall Materiality?

The data from respondents indicate that the firms typically follow gross profit, or net profit (profit after income taxes), or profit before income taxes, or total assets to determine the overall materiality. Six firms follow profit before taxes and other firms follow either net profit or total assets to determine the overall materiality. Most of the respondent's report that if the

company has no net profit, they use gross profit as a basis for overall materiality determination.

The firms allow application of alternative basis under following conditions:

- If the company is typically profitable, but incurring loss in the present year, firms use other measures such as sales turnover, or revenues, or gross profit for overall materiality.
- When the organisation is in break-even position or fluctuating scenarios in terms of profitability from one year to another year, they use gross profit, or total sales revenues or profit before income and interest for overall materiality.
- When the operating conditions are very poor, they use equity or total assets as a measure of overall materiality.

Question 2

What rates are used on the quantitative level for fixing the overall materiality?

The participants indicate that the percentages applied on the quantitative benchmarks to determine the overall materiality usually depend upon industry characteristics, bulk of transactions, amount of total assets and total liabilities. Most of the firms specify that the usual percentage applied is 5% on the profit before taxes, where other use 5 to 10 percentage on the same. This rate varies from 0.25 to 2 percentage applied on total assets or total revenues.

Question 3

How can you establish the level of Tolerable (acceptable) misstatement?

The interview responses indicate that the evaluation of acceptable amounts relies on the engagement risks, exposure to fraud, misstatements from previous year, and the chance of misstatements in current years' accounting. It is also indicated that the percentage used for tolerable misstatements is typically ranges 50% to 70% of overall materiality level. They provide the following situations where firms apply lower percentage to determine the tolerable misstatements:

- High engagement risk such as risky industry, high pressures from the market, initial (first) functions etc.
- Inefficient corporate governance, inefficient accounting staff, management's pressures. etc.
- The large amount of prior period misstatements identified.

- High possibility of misstatements in the current period's account balances.

Question 4

Which percentages are employed to establish the threshold for Trivial (insignificant) misstatement?

All the firms agree that the Trivial Misstatements level depends upon the total amount of transactions or business operations or total account balances. Six firms apply 2 to 4 percent of the overall materiality level whereas others use 3 to 6 percentages of overall materiality level.

Question 5

How do firms handle identified and unidentified misstatements?

All the firms follow almost same procedures to treat total amount of undetected and detected misstatements amounts. At first, they see whether the financial statements include prior period misstatements that were not corrected and noted by the earlier period's auditors. If they can identify the misstatements, they consider these amounts to determine the overall materiality of current period. For the undetected misstatements they provide notes that they used best care for identifying misstatements and if found in future they will consider it following year.

Question 6

If any item persists as an error or fraud from the prior financial statement, what course of action do you undertake?

Our analysis of the responses indicates that, if the misstatements are deliberate or fraudulent, the auditor should address the potential occurrence of fraud and initiate appropriate actions, such as reporting the issue to law enforcement or regulatory authorities. In cases where the misstatements are unintentional, collaboration with management is necessary to implement measures preventing a recurrence. In the event that an item remains an error or fraud from the prior financial statement, auditors are obliged to thoroughly investigate the matter, engage in communication with management, assess the impact on other audit areas, and report to regulatory authorities.

5.2 Analysis of structural equation modeling results

Our study employed Structural Equation Modeling (SEM) to verify the hypothesis in two phases: the measurement segment, identified as the

measurement model, to validate and ensure the reliability of measurement constructs, and a structural segment termed the structural model, scrutinizing the linkage between the constructs (Anderson and Gerbing, 1998).

5.2.1 Reliability and validity of data

The Cronbach's alpha (α), Composite Reliability (CR), Average Variance Explained (AVE), and Factor Loading were utilized to assess the convergent validity. The threshold values for all these criteria are illustrated in the Table-3. Following Rahi and Ghani's (2019) guidance, CR and α values were confirmed to surpass 0.70. Factors loading exceeding 0.70 and AVE surpassing 0.50 were deemed to ensure satisfactory convergent validity (Hair et al., 2017; Hussain et al., 2023). The results revealed that Cronbach's alpha values ranged from 0.866 to 0.879; CR values fell between 0.917 and 0.923; AVE values ranged from 0.737 to 0.786; and items loading exceeded 0.70, affirming the convergent and divergent validity of the constructs. Consequently, the validity and reliability of our study's constructs were achieved based on the aforementioned benchmarks.

Table 1: Reliability and validity statistics

Variables	Items	Factor loading	Cronbach's Alpha (α)	Composite Reliability (CR)	Average Variance Explained (AVE)
Information needs	---> INF1	0.714	0.879	0.917	0.737
	---> INF2	0.885			
	---> INF3	0.939			
	---> INF4	0.881			
Materiality Judgement	---> MJ1	0.872	0.866	0.923	0.786
	---> MJ2	0.878			
	---> MJ3	0.909			

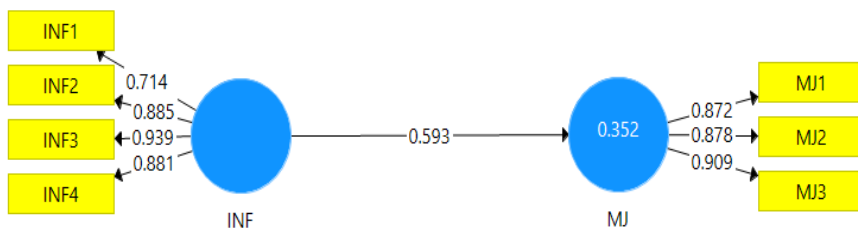


Figure 1: Outer Model

5.2.2 Determining discriminant validity

Evaluating discriminant validity is vital as it presents the distinctions between the constituents of the model (Yamin et al., 2020). The assessment of discriminant validity employs the latest Fornell and Larcker test (Fornell & Larcker,1981), proposing that the square root of AVE must exceed the correlation with other constructs, confirming the discriminant validity of the constructs, and measures a distinct concept (Rahi et al., 2018). Results from the Fornell & Larcker analysis indicated that the square root of each construct surpasses the corresponding constructs’ correlation, affirming that the construct is distinct. The outcomes of Fornell & Larcker test are depicted in Table 2.

Table 2: Discriminant validity data

	INF	MJ
INF	0.859	
MJ	0.593	0.886

Although Fornell & Larcker test is widely employed by the previous studies, it has some limitations (Kline, 2023). Gold et al. (2001) advocate the Heterotrait-Monotrait Ratio as a more congenial test for computing discriminant validity. Consequently, we used Heterotrait-Monotrait Ratio, with the condition that values must be smaller than 0.85 or 0.90, affirming that the construct measures a separate concept (Kline, 2023). Our results with HTMT lower than 0.85 confirm discriminant validity (See Table 3).

Table 3: Heterotrait-Monotrait Ratio (HTMT)

	INF	MJ
INF		
MJ	0.652	

The cross-loading method was also applied to determine the discriminant validity of the construct. This method suggests that the loadings of a construct must be bigger than the corresponding construct loadings, to indicate the constructs as (Samar et al., 2017). The outcomes disclose that the factor loadings of each construct were more than the loadings of other constructs, thus ensuring the distinct nature of the construct. Table 4 illustrates the cross-loading information.

Table 4: Cross loadings data

	INF	MJ
INF1	0.714	0.370

INF2	0.885	0.561
INF3	0.939	0.563
INF4	0.881	0.514
MJ1	0.547	0.872
MJ2	0.389	0.878
MJ3	0.597	0.909

Source: Analysis results

5.2.3 Structural model

5.2.3 (a) Multicollinearity issue

The flowing table 4 ensures that the VIF values are less than 3.3 which mean that our study has no multicollinearity concern.

Table 5: Collinearity statistics

	VIF
INF1	1.565
INF2	2.848
INF3	2.302
INF4	2.703
MJ1	1.948
MJ2	2.577
MJ3	2.461

5.2.3 (b) Hypothesis testing

We tested our hypothesis 2 using the R^2 for explaining variance, Co-efficient (β), T-value and P value for evaluation and decision making. Thae table- 6 presents summary of the all-reported values for evaluation. It demonstrates that the information demanded by the stockholders and stakeholders has significant impact on materiality judgements of auditors (INF ->MJ, $\beta=0.593$, $t=15.530$, $P< 0.01$). Thus, the table proves that the hypothesis 2 is accepted. The R^2 (adjusted) value (0.350) implies that 35% of dependent variable (information needs) can be explained by the dependent variable (materiality judgements). The findings indicate the Q^2 value for materiality judgements is 0.261exceeding the criterion value of 0, signifying ample predictive relevance of the model. Fig. 2 presents the structural model.

Table 6: Hypothesis testing results

Materiality Judgements						R^2 (Adjusted)	Q^2	Effect size Results
H	Path	β	T-value	P-value	Decision	f^2		
H1a	INF ->MJ	0.593	15.530	0.000***	Accepted	0.542		Large

Note: * not significant at $p \geq 0.05$; **significant at $p < 0.05$; and ***; significant at $p < 0.01$. Effect Size, $f^2 \geq 0.02$, small; $f^2 \geq 0.15$, medium; and $f^2 \geq 0.35$ substantial.

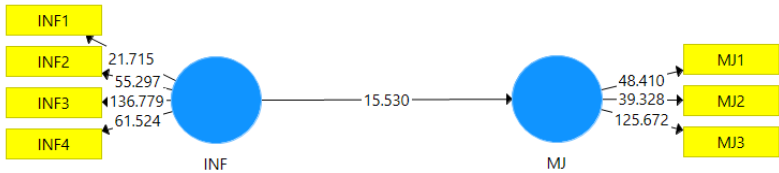


Figure 3: Inner model or structural model.

6. Summary of findings and research contribution

The analysis of interview questions indicates the materiality level determination totally hinges on the quantitative and qualitative factors and the professional judgements of the auditors. The results reveal that the materiality practice is almost consistent across the practicing auditing firms in terms of determining the overall materiality level, tolerable misstatements level, clearly trivial misstatements amounts and the treatments of detected and undetected misstatements, and thus accepting hypothesis 1. This finding is consistent with the Eilifsen and Messier (2018) and Quick et al. (2023) implying that the application of materiality in audit planning, revealing significant agreement among firms on benchmarks and percentages used, handling of detected and undetected misstatements, showing consistent practices across firms. Overall, the study highlights consensus among firms in materiality determination and adherence to auditing guidelines. This consistency suggests a standardized approach across firms, indicating a common understanding and application of materiality concepts in audit planning and execution. This finding contributes to a deeper understanding of how auditing firms implement materiality guidelines in practice, highlighting the stability and reliability of materiality practices across the industry and exhibits a high degree of uniformity within the auditing profession.

The structural equation modeling analysis outcomes evidence that the information necessities of various users' group can positively and considerably predict the materiality judgements of auditors, accepting hypothesis 2. For example, the auditors consider the cost involved in the auditing process incurred by the company to determine the procedures, plan of execution of audit in details. They also consider interest of the stakeholders such as the shareholders, creditors, government and others while deciding for materiality judgements. These findings are similar with the findings of Hasan (2023), Nurin & Chaity (2020) and Christensen et al. (2018) in which they have focused on the investors and other user's considerations for determining the materiality decisions in regard to measurement, presentation, and disclosures of financial and non-financial items. This finding highlights the importance of considering stakeholders' interests, such as shareholders, creditors, and government entities, in determining materiality thresholds. By incorporating user perspectives into materiality assessments, auditors can enhance the relevance and reliability of their judgments, contributing to more effective communication of financial information to stakeholders. Overall, the study expands the understanding of the factors influencing materiality judgments by emphasizing the role of both quantitative and qualitative considerations, as well as professional judgment, in the determination process. By recognizing the multifaceted nature of materiality, the research contributes to a more comprehensive understanding of how auditors weigh various factors to establish materiality thresholds, thereby enriching auditing theory and practice.

7. Implications

The findings of this research provide a direction for selecting appropriate the materiality guidelines and thresholds and valuable information concerning the detected and undetected misstatements. The findings also provide the importance of stockholders and stakeholders information demands for materiality decisions and disclosures that may help the practicing auditors for materiality judgements. The findings of this research can be beneficial to the future researchers who intend to study materiality; researches where materiality might be used as a control variable. Similarly, researchers who intend to study behavioural implications can use this finding for making case study. Additionally, the information provided in our study can be applied for setting standards in auditing and the accounting students can use such findings for well understanding of materiality concept and how it is applied practically.

8. Conclusion

Materiality is a crucial concept in auditing, impacting auditors, clients, and various user groups. The determination of materiality levels is influenced by both quantitative and qualitative factors, as well as the auditor's expectations of information needs from different financial statement users. Auditing standards on materiality set by standard-setting bodies guide audit firms in shaping their approach to audit procedures. Understanding how the materiality concept is applied in a real-world setting can benefit auditors, accounting students, and financial statement users.

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Appendix-I

Questionnaire Items

Users' Information Needs

Cost-benefit analysis of client (managers or owners) can limit our investigation for materiality decisions.

Information needs of owners or shareholders determine our extent of efforts for materiality decisions.

Information demanded by the creditors are considered for materiality judgements.

The type of decisions the users make influence us in materiality investigations.

Materiality Judgements

We use materiality judgements for correct user's analysis of financial statements.

We prefer to use materiality judgements for determining the scope of audit.

We advocate the managers and other auditors for applying professional judgements for materiality decisions.