

Auditor choice in the voluntary sector: the case of smaller organizations

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Abstract

Smaller organizations are less likely than larger organizations to engage a high-quality auditor to signal credibility to potential donors, but they may still have incentives to engage a high-quality auditor (for instance, to protect themselves from a potential reputational loss). In this context, we find that fundraising voluntary organizations, which are particularly likely to be exposed to reputational concerns, because a poor reputation may have a direct negative impact on fundraising, are more likely to engage a high-quality auditor than are other voluntary organizations. Additional analysis reveals that fundraisers are more likely to engage a Big 4 auditor than an industry specialist; this suggests that the motivation for engaging a high-quality auditor may be to use the auditor as a scapegoat rather than to ensure superior knowledge and advice. We find that debt ratio, organizational complexity, size and financial health are also drivers of auditor choice in small, voluntary organizations.

Keyword: auditor choice, non-profit auditing, agency theory, auditor reputation

1. Introduction

This paper examines auditor choice in small voluntary organizations. The voluntary sector differs significantly from the for-profit sector in certain aspects of its financing, and the purpose of this paper is to test whether smaller fundraising voluntary organizations are more likely than other smaller voluntary organizations to engage a high-quality auditor. We also investigate whether prior findings on determinants of auditor choice from studies in the for-profit sector are transferable to the voluntary sector.

Firms often pay more for a Big N audit.¹ This indicates that they get something extra from this audit; that is, the audit is of higher quality, and Big N is often used as a proxy for audit quality in audit research.² Prior research suggests that engaging a Big N auditor or a specialist auditor can be used to signal to potential and current stakeholders that the financial accounts are of high quality and can be relied upon for decision-making purposes (e.g. DeFond, 1992; Simunic & Stein, 1987); thereby reducing agency costs. Choosing one auditor over another can lead to increased access to funding. The determinants of auditor choice and the related themes of audit demand and auditor changes are previously investigated in a large number of studies of both public and private for-profit firms (e.g. DeFond, 1992; Wallace, 2004). Few of these studies are conducted with samples of small firms. The studies of Knechel et al. (2008) and Niskanen et al. (2010) are exceptions with their focus on auditor choice in smaller for-profit firms.

¹ In this paper we use the term Big N when we describe prior research as how many and which audit firms that are labeled under the Big N umbrella has changed over time from Big 8 to Big 6 to Big 5 and finally to Big 4. When we use the term Big 4, we use this term as it is used today in both research and professional literature to include the firms Ernst & Young, KPMG, PricewaterhouseCoopers and Deloitte.

² It should be noted that prior research (e.g. Francis & Wang, 2008) show that the use of a Big N auditor does not necessarily lead to higher accounting quality in all contexts, and the potential audit quality difference between Big N and non-Big N auditors may be perceived and not actual. In this paper we do not distinguish between actual and perceived audit quality.

The number of studies on auditor choice in the voluntary sector is small (e.g. Beattie et al., 2006; Hay & Davis, 2004; Tate, 2007). Findings from these studies are mixed/inconclusive and occasionally differ from comparable findings in the for-profit sector. As a consequence, the main purpose of our study is to contribute to a better understanding of auditor choice in the voluntary sector and in particular in smaller voluntary organizations.

The voluntary sector is a large part of a modern economy and differs from the for-profit sector as the organizations in this sector typically have no owners and the primary purpose of the voluntary sector is not to maximize profit but to create social impact. In addition, donations are an important source of financing. Voluntary organizations (large and small) must often cope with instability in the types of their funding (Gronbjerg, 1991) and are likely to see the funding shrink considerably if questions are raised, for instance, about cost control or if their reputation is harmed. In this context, Reheul et al. (2018) find that being audited by an industry specialist is positively related to future financial contributions. While some agency conflicts are comparable in the two sectors, the possible agency conflict between future donors and the voluntary organization is unique to this sector (Hofmann & McSwain, 2013). Prior research also indicates that signaling through the financial statements are less useful in the voluntary sector because donors do not necessarily collect financial information before donating (Gordon & Khumawala, 1999; McDowell et al., 2013; Parsons, 2007; Waniak-Michalak & Zarzycka, 2015), in particular when donating to smaller voluntary organizations (Tinkelman, 1998). As a consequence, auditor choice is likely to be explained by other factors than agency theory and signaling. We argue that auditor choice in this setting can be explained by factors such as the perception of receiving superior advice to avoid reputational loss, or by using the auditor as a scapegoat to reduce reputational loss in case of negative publicity.

We develop a hypothesis to test whether fundraising voluntary organizations are more likely than other voluntary organizations to engage a high-quality auditor. We then use the model that

we build to investigate whether determinants of auditor choice in the voluntary sector differ from determinants in the for-profit sector.

We study auditor choice in a sample of 7,665 organization-year-observations from Norwegian voluntary foundations, clubs, and associations. The Norwegian setting provides an excellent opportunity to study auditor choice in smaller voluntary organizations because such organizations can file their accounts in the Norwegian register for accounting information and some of these organizations have their accounts audited. Consequently, we can study auditor choice in a setting where major stakeholders are less likely to use the financial statement to make decisions about providing funds to the organizations than in previously investigated settings. As the Big N firms audit a large part of the sample, we are, in contrast to prior research in the voluntary sector (see Reheul et al., 2018), able to investigate auditor choice in a setting where Big 4 firms have a market share of 24.1%/44.7% (calculations based on count and revenue respectively). In addition, a large non-Big 4 firm audits 19.6%/29.7%.

We find that fundraising voluntary organizations are more likely than other voluntary organizations to engage a high-quality auditor. The finding is robust according to various robustness tests such as propensity score matching, inclusion/exclusion of control variables, and various samples and time periods.

In additional analysis, we examine whether the fundraising voluntary organizations are more likely to engage a Big 4 auditor or an industry specialist (which is not Big 4 firm) than do other voluntary organizations. If the motivation for engaging a high-quality auditor is to get superior advice and auditing, the organizations should be more likely to choose the industry specialist. If, however, the motivation for engaging a high-quality auditor is to have an “insurance” against reputational loss and to have someone to blame in the case of negative publicity, the organizations should be more likely to engage a Big 4 auditor (because they are generally more well-known as high-quality auditors among the general public, as noted in scapegoat theory).

Our findings are generally in line with the scapegoat theory, suggesting that fundraising voluntary organizations are more likely to choose a Big 4 audit firm than an industry specialist, compared to the choices of other voluntary organizations.

We also find that auditor choice in voluntary organizations significantly depends upon the debt ratio in the organization and the organization's level of organizational complexity. This finding is in line with prior findings from private firms (e.g. Knechel et al., 2008; Niskanen et al., 2010) as well as prior research on public firms (e.g. DeFond, 1992). The finding indicates that both external and internal factors have an impact on auditor choice in smaller voluntary organizations and that reasons for hiring a high-quality auditor partly can be explained by agency theory. In addition, we find that the size and the financial health of the organization (whether or not the organization is experiencing a loss) are also drivers of auditor choice in small voluntary organizations.

This paper contributes to the literature in several ways. Financing activities in the voluntary sector differ from those in the for-profit sector, and prior findings on the impact of these activities on auditor choice are mixed/inconclusive (Hay & Davis, 2004; Beattie et al., 2006; Tate, 2007; Harris et al., 2019). Despite the importance of donations to fund voluntary organizations, no prior research of which we are aware investigates the impact of being a fundraising organization on auditor choice in smaller voluntary organizations. We find that whether an organization is a fundraising voluntary organization has an impact on its auditor choice. We argue that the incentives fundraising organizations have for using a high-quality auditor differ from the incentives of other voluntary organizations because they rely more on collecting money from the general public and therefore need to care more about their reputation. Hiring a high-quality auditor can help in building and maintaining a good reputation. Furthermore, we contribute to the industry specialist literature and the theory of audit demand by showing that voluntary organizations may choose the Big 4 auditors over the industry

specialist in organizations where agency costs are likely to be high and signaling through the financial statements is limited. The motivation behind this choice may be to use the auditor as a “scapegoat,” and a more well-known and reputable auditor may work better as a “scapegoat” than a less reputable auditor.

Prior research on determinants of auditor choice in smaller for-profit firms shows that the demand for a high-quality audit may stem from three sets of characteristics of which two are likely to be of relevance also in a market of smaller voluntary organizations: financial structure and organizational complexity (Knechel et al., 2008). We extend these findings and show that smaller voluntary organizations with more debt and high organizational complexity are more likely to choose a high-quality auditor than organizations with less debt and less organizational complexity. These findings are in line with prior findings in the for-profit sector.

The remainder of this paper is structured as follows. In section two we present prior literature relevant to our study and develop our hypothesis. Section three presents our research design. In section four we report findings from our main analysis and several additional analyses. Section five concludes our paper.

2. Prior literature and development of hypothesis

Theories on audit demand

The principal-agent theory is frequently used to explain audit demand. According to this theory, a principal (an owner) hires an agent (a manager) to run his business. For the principal to be able to judge the agent’s performance, the agent must report financial information to the principal in the form of a financial statement. Due to information asymmetry (the agent knows more about the business than does the principal) and interest conflicts (the agent may choose to maximize his own self-interest instead of focusing on the principal’s interest), the demand arises

for an independent auditor to reduce monitoring costs and add credibility to the organization's financial accounts and thereby reduce the agency costs. Researchers in audit demand often distinguish between demand arising from these two factors separately, i.e. agency demand and information demand (e.g. Beattie & Fearnley, 1995; Hay & Cordery, 2017). Given that we also include other stakeholders who have an interest in the financial statements of a company in the model, we get a more generalized agency theory (Hill & Jones, 1992). This generalization helps us explain audit demand, for instance, in companies in which the owner and the manager are the same person (for instance, if there is a debtholder that relies on the financial statement for decision-making purposes). With an underlying assumption that some auditors deliver higher audit quality than others (and thereby add more credibility), the principal-agent theory is also relevant to explain auditor choice; that is, why one audit firm is chosen over another because organizations will choose a high-quality auditor to lower agency costs and high-quality auditors may be chosen to signal to stakeholders that the financial statements can be trusted. Prior research shows that companies with more debt are more likely to choose a high-quality auditor (i.e. auditors that have a reputation to deliver high-quality audits) than companies with less debt (e.g. DeFond, 1992). Pittman and Fortin (2004) finds that companies that recently went public can obtain lower borrowing costs if they engage a Big N auditor and underwriters may require a Big N auditor in an IPO-process (Hogan, 1997). These findings are likely to generalize to the bond market, i.e. reputable underwriters are likely to work with high-quality auditors (Lou & Vasvari, 2013).

An alternative theory for explaining audit demand is the insurance theory. Auditors are said to have "deep pockets" and can be sued if something goes wrong; in effect, this suggests that they may play the role of an insurance company. This theory is not particularly relevant in the Norwegian setting because Norway is known as a low litigation risk environment (Hope & Langli, 2010) A theory related to the insurance theory is the scapegoat theory. Wallace (1980,

2004) suggests that this theory plays a role in the public sector as an “insurance from blame” where public sector managers can blame the auditor when something goes wrong. Hay and Cordery (2017) suggests that the value of auditors may be that they can take the role as “an independent scapegoat” (Hay & Cordery, 2017, p. 6). According to this theory, one would expect that organizations that have a reputation to protect may want to insure themselves, at least partly, against reputational loss by hiring a high-quality/expert auditor so they can then publicly claim that they only did what their auditors told them or that the auditor did not inform them that their internal control was not of sufficient quality (things that might happen that may lead to reputational loss). Obviously, responsibility still lies with management as auditors’ responsibility is restricted to the overall objectives of an audit: “To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework” (IFAC, 2009).

Ojala et al. (2016) emphasizes that the demand for audits may not necessarily be related to agency or insurance issues but that audit demand can also be related to the needs of the firm or the entrepreneurs. An external audit will not only contribute to financial statements of higher quality but will also include recommendations to management (Hay & Cordery, 2017). These recommendations may be related to areas such as internal control and accounting/reporting. The client may also profit from easy access to highly skilled professionals who are valuable discussion partners in areas such as business strategy and reputation building. The auditors are also familiar with many similar organizations in an industry and thus have more of a big picture perspective than the client. For instance, prior research on private for-profit firms shows that when the quality of relationship between the auditor and the client is higher, the client receives a service that goes “beyond the basic requirements of the audit itself” (Herda & Lavelle, 2013,

p. 113). A high-quality audit may therefore restrict, among other things, the risk of reputational loss.

Prior research on auditing in the voluntary sector

In this section we review research papers that are of particular importance to our paper. Voluntary sector organizations typically have no owners and differ from public and private firms in areas such as culture, organizational structure, financing (Tate, 2007), as well as goals, stakeholders and risk (Reheul et al., 2013). Voluntary organizations differ in size and type and include large organizations like hospitals and universities (Vermeer et al., 2009) and also include smaller organizations such as sports clubs and activist organizations (Hay & Davis, 2004). When trying to understand more about why some of these organizations choose to use a high-quality auditor even though they may have to pay a fee premium for such a service (Beattie et al., 2001), explanations may differ from those suggested in the markets for public and private firms. Before developing our hypothesis and the model we need to examine auditor choice in the voluntary sector, we therefore review papers that examine the determinants of auditor choice in the voluntary sector of the economy. For a more general review of the auditor choice literature, we refer to literature reviews conducted on this topic by Vanstraelen and Schelleman (2017) and Habib et al. (2019).

Hay and Davis (2004) studies auditor choice in a sample of 380 incorporated societies³ of differing size from New Zealand (organizations with limited liability that are restricted from profit distribution). Total revenues of the organizations in the sample differ from zero to \$ 48 million. In a subsample of 38 organizations, findings indicate that contrary to expectations

³ Incorporated societies include “sports and social clubs, cultural and religious groups, and special interest and activist organizations” New Zealand Companies Offices. (2022). *About incorporated societies*. Retrieved 08/02/22 from <https://is-register.companiesoffice.govt.nz/help-centre/getting-started/about-incorporated-societies/>.

based on findings from the for-profit sector of the economy, large, incorporated societies, societies that have a high debt to asset rate and societies with a high salary to revenue proportion are not more associated with Big N auditors than other societies. By contrast, incorporated societies that have a higher proportion of their revenue coming from members than other societies are more likely to have a Big N auditor.

Beattie et al. (2006) investigates why charities choose to change auditor and finds two major differences from the for-profit sector: audit fees are not an important variable in this decision and charities that have a Big N auditor are more likely to change auditors than do other charities. Given that charities pay relatively little for their audits at the same time as the industry specialist in this sample is not a Big N auditor, these findings are not surprising. The two other variables that are found to have an impact on auditor changes are the existence of an audit committee and recently lowered income in the charity.

Tate (2007) studies auditor change *and* auditor choice in a sample of approximately 16,000 US non-profit organizations that receive more than \$300,000 in federal funding. Contrary to Beattie et al. (2006), Tate (2007) finds that audit fee has an impact on auditor change. Changes in operational structure as well as the reputation of the management of the organization also have an impact on auditor change. When it comes to variables that have an impact on which auditors the organizations chose when they change their auditor, findings are less conclusive, and no variable is significant across all analyses. Findings do indicate that variables such as changes in financing and operational structure have an impact on the choice the organizations make.

Harris et al. (2019) investigates the determinants and consequences of engaging a local industry specialist in the nonprofit sector. The organizations in the sample include hospitals, universities and human service organizations that receive more than \$ 500,000 in federal funding. Regressions are run on a sample of around 20,000 nonprofit-year observations. In each of the markets studied, the local industry specialist is the auditor that is the consistent market leader.

Higher organizational complexity, higher governance quality and poorer financial health are the variables that are found to be associated with hiring a non-Big N local industry specialist. Organizations that engage a local industry specialist are found to experience shorter audit report lag, and they also receive more direct future donations.

To summarize, findings on determinants of auditor choice in the voluntary sector are few, inconclusive (Tate, 2007), mixed (Beattie et al., 2006; Tate, 2007) and differ from comparable findings in the for-profit sector (Beattie et al., 2006; Hay & Davis, 2004). Only one of these studies focus on smaller voluntary organizations and this study includes only a small number of organizations (Hay & Davis, 2004). As some studies on auditor choice have been conducted in the market segment of smaller private companies (e.g. Knechel et al., 2008; Niskanen et al., 2010), we will build on these studies to build our model to test our hypothesis and to explore whether prior findings from the for-profit sector are transferable to the voluntary sector of the economy.

Hypothesis development

Prior research in private firms shows that firms with higher agency costs are more likely to use Big N auditors (e.g. DeFond, 1992; Francis & Krishnan, 1999). Organizations in the voluntary sector of the economy typically fund their activities by membership fees, government subsidies and donations from the general public. We can identify a principal-agent relationship also in these types of organizations, the relationship between current and potential donors (i.e. members, government and/or the general public) as the principal⁴ and the organizations' managers and employee as agents who may misuse their trust and engage in bad spending or

⁴ Some will argue that agency theory is not applicable in organizations that have no owners (see Vermeer et al. 2009). Vermeer et al. (2009) suggests that resource dependency theory can then be used to explain fee differences: according to this theory, what will explain an organization's decisions is its need for resources.

might be mistrusted because they have a potential to spend inappropriately. As a consequence, donors may donate less to an organization or even drop giving at all (Hay & Cordery, 2017), and the agent has an incentive to build, sustain and possibly signal its reputation as a trustworthy organization to attract donations. Kitching (2009) finds in her study of larger charities that donors give more to charities that are audited by a Big N firm. Her findings suggest that charities use the appointment of a high-quality auditor to signal that their financial statements are credible. Reheul et al. (2018) find that not for profit organizations that are audited by an industry specialist partner receive more future contributions. Further organizations with a big N auditor receive more future contributions but the auditor variable is only significant at the ten percent level. Harris et al. (2019) finds that voluntary organizations that engage a local industry specialist auditor receive more future donations. Smaller voluntary organizations are not necessarily likely to be able to communicate with their donors through the financial statements (Kitching, 2009), and we therefore argue that the reason for engaging a high-quality auditor for these organizations is not likely to be that they can signal trustworthiness through their choice of a high-quality auditor.

Fundraising can be defined as all sorts of activities “to collect money for a political party, charity, school etc.” (The Britannica Dictionary). Some voluntary organizations such as the Red Cross, have fundraising as a part of its main purpose; they collect money from the general public and their fundraising activities are not meant to benefit its members but to achieve other purposes. We call these organizations “Fundraising voluntary organizations”, and we expect that such organizations will not necessarily communicate with their donors through the financial statements and will therefore seek other means to signal trustworthiness to donors such as registering with a member of ICFO (The International Committee on Fundraising Organizations). They might engage in specific efforts to build a public reputation as a trustworthy fundraising organization. Research in charitable giving shows the importance of

reputation to attract donations and enhance trust (e.g. Bennett & Gabriel, 2003; Meijer, 2009) and suggests that reputations originate from financial visibility, financial efficiency and accreditation status (Peng et al., 2019).

We suggest that an additional way for fundraising voluntary organizations (including smaller organizations) which rely on their reputation to collect money, to build and keep a good reputation is to engage a high-quality auditor. This is because a high-quality audit may help an organization to impose better cost control, lead to a smaller fraud risk and/or improve the internal control in the organization and because a high-quality audit is likely to include better guidance and recommendations than a low-quality audit. Thus, leaders in organizations that rely on their own reputation to collect money are likely to engage a high-quality auditor to build a good reputation and to minimize the risk of reputational damage even in those situations where the donors are not making their decisions to donate based on using information in the financial statement. In addition, prior research from the for-profit sector (Huang & Kang, 2018) shows that highly reputable companies are more likely to engage an industry specialist (i.e. a high-quality auditor) than do less reputable companies.

An alternative theory to explain auditor choice in fundraising voluntary organizations is the scapegoat explanation of the demand for auditing. Both large and small voluntary organizations that rely on their reputation to finance activities may choose to engage a high-quality auditor to have someone to blame if things go wrong, and it is more likely that such organizations choose to use a high-quality auditor.

The arguments presented so far suggest that fundraising voluntary organizations are more likely to engage a high-quality auditor than do other voluntary organizations. There are, however, arguments in the other direction. Organizations that get a high proportion of their revenue from members may have incentives to engage a high-quality auditor to signal credibility to their members (Hay & Davis, 2004). In line with this, Hay and Davis (2004) finds that the likelihood

that voluntary organizations engage a Big N auditor increase with the relative proportion of revenues from members (rather than outside donors), implying that organizations with a high proportion of revenue from donations and grants are less likely to engage a Big N auditor. We do not examine the relative importance of income sources, but just consider whether being a fundraiser matters for auditor choice. Smaller organizations are also less likely to signal through auditor choice. In this setting, we expect the former effect to dominate (i.e. motivations to engage a high-quality auditor to protect the organization's reputation either by preventing reputational loss through superior auditing or by minimizing reputational loss by using the auditor as a scapegoat).

In general, we expect that voluntary organizations that use donations from the general public as an important means to fund their activities are more likely to engage a high-quality auditor than other organizations in the voluntary sector. We propose the following hypothesis:

Fundraising voluntary organizations are more likely to engage a high-quality auditor than other voluntary organizations.

3. Research design

The Norwegian context

The Norwegian market for audit services

In 2020, the five largest Norwegian audit companies had total revenues of 12, 85 billion NOK.⁵ EY was the largest with total revenues of 3,5 billion, and BDO was the fourth largest with total revenues of 2, 2 billion NOK. KPMG had total revenues of 1,76 billion. RSM as the sixth largest audit firm had total revenues of 358 million NOK (Losnegaard, 2021). The Financial

⁵ 1 EUR=10.96 NOK as of February 28, Norges Bank. (2023). *Exchange rates*. Retrieved 28/02/23 from https://www.norges-bank.no/en/topics/Statistics/exchange_rates/?tab=currency&id=EUR.

Supervisory Authority of Norway (“Finanstilsynet”) uses the term “Big 5” when describing the Norwegian market for auditing, and the authority includes BDO as a part of Big N. BDO was in 2016 the third largest firm based on total revenues and the largest firm based on number of clients. When it comes to auditing public companies, BDO was (as of 20/03/18) the fifth largest firm auditing 29 such companies, i.e. smaller than KPMG, the fourth largest, who was the auditor of 58 public companies (Finanstilsynet, 2018).

The voluntary sector

The voluntary sector can be defined as “the part of the economy that consists of non-profit-making organizations, as opposed to the public and private sectors” (Collins Online Dictionary).

The Norwegian voluntary sector is an important part of the economy; 2/3 of the population aged 15+ are involved in voluntary work, and 78% of the population are members in at least one voluntary organization (Frivillighet Norge, n.d.).

Voluntary organizations in Norway can choose from among several different organizational forms: non-profit limited companies, non-profit foundations, and clubs and associations⁶, for example sports clubs, churches. Charity is not a legal construct nor a distinct organizational form in Norway. Non-profit foundations and non-profit limited companies must register in the Register of Business Entities and submit annual accounts; whereas clubs and associations are allowed, but not required, to register or to file accounts unless their total assets are valued at more than 20 million NOK or more than 20 employees (yearly average). These clubs and associations are required to follow the Accounting Act (Regnskapsloven, 1998, §1-2).

⁶ “Clubs and associations” is a distinct organizational (legal) form; it is not possible to distinguish a club from an association based on available registration data.

Voluntary organizations may register in the Register of Non-Profit Organizations (“Frivillighetsregisteret”). Registration is free of charge, and there are no fees involved. Registration is non-compulsory, and the registrants may receive several benefits such as VAT-compensation and can participate in a Norwegian allotment program (The Brønnøysund Register Centre, 2021).

Organizations in the Norwegian voluntary sector finance their activities through fundraising, loans, membership fees, sales, interest, government grants and other means. Fundraising is not legally regulated but voluntary organizations that engage in fundraising can choose to register with the Norwegian Control Committee for Fundraising (Innsamlingskontrollen, n.d.), established in 1999. Voluntary organizations that register with this committee are organizations that collect money from the general public on a regular basis and conduct fundraising across large geographical areas, i.e. regionally or nationwide fundraising, such as the Norwegian Red Cross. We use the term “Fundraising voluntary organization” to label the organizations that are registered. Fundraising voluntary organizations may, similar to other voluntary organizations, choose different organizational forms. To register, an organization must behave in accordance with a number of specific requirements, among other things to have their accounts audited by an external auditor. When the registration is accepted, the organization is listed on the Norwegian Control Committee for Fundraising’s homepage. Consequently, the registration is a way for fundraising voluntary organizations to signal trustworthiness to present and potential donors because the donors may check whether an organization is listed. Registration is not compulsory and non-listed Norwegian voluntary organizations may also engage in fundraising. Such fundraising will typically be related to local activities.

Audit requirements in the Norwegian voluntary sector

Audits are compulsory for all Norwegian foundations, irrespective of size, and for all limited companies (including voluntary limited companies) larger than specified threshold values, (at present) total revenues larger than 6 million NOK, total balance sheet larger than 23 million NOK and the entity has more than 10 employees. Clubs and associations are not obligated to have their accounts audited unless they have a total balance sheet larger than 23 million NOK or more than 20 employees (yearly average). (Altinn, 2021; The Brønnøysund Register Centre, 2022). Audit requirement may also follow from an organization's statutes (which is the case for many sports clubs) or if certain grants are received from public authorities.

Sample

We obtain our data from the database PROFF Forvalt. PROFF Forvalt is a Norwegian database containing financial and non-financial information on Norwegian firms and organizations. A total of 3,019 foundations, clubs, and associations with total revenues of more than 1 million NOK in the latest registered fiscal year (i.e. 2020) are listed in the database.⁷ To make sure we only include voluntary organizations in our sample, we only include foundations, clubs, and associations that are registered in the official register of non-profit organizations (The Brønnøysund Register Centre, 2021). This limits our sample to 1,380 voluntary foundations, clubs, and associations.

We obtain data for the period 2011-2020, which grants us 13,800⁸ organization-year observations. We exclude observations that have not been audited as well as observations with

⁷ As there is no data in this database that enables us to distinguish between limited not-for-profit and limited for-profit firms and organizations, we restrict our search to foundations, clubs and associations.

⁸ In this sample of 13,800 organization-years, also organizations founded during the sample period are included with ten observations each. These organizations have missing data for the organization-years prior to foundation and will consequently not be in the final sample.

missing information on auditor or on other variables included in our analyses.⁹ Our final sample consists of 7,665 organization-year observations with data from 1,052 different organizations, included with one to ten observations. The sample selection procedure is outlined in table 1.

[Insert table 1 here]

Model

We specify the following logistic regression model to test our hypothesis:

$$(1) \text{ High} - \text{quality}_{i,t} = \beta_0 + \beta_1 \text{Fundraising}_{i,t} + \beta_2 \ln \text{TotalAssets}_{i,t} + \beta_3 \text{DebtRatio}_{i,t} + \beta_4 \text{Subsidiaries}_{i,t} + \beta_5 \text{OrgForm}_{i,t} + \beta_6 \text{CurrentRatio}_{i,t} + \beta_7 \text{ROA}_{i,t} + \beta_8 \text{LOSS}_{i,t} + \beta_9 \text{Subdivisions}_{i,t} + \beta_{10} \text{City}_{i,t} + \beta_{11} \text{OperatingMargin}_{i,t} + \text{Year fixed effects} + \text{Industry fixed effects} + \varepsilon_{i,t}$$

To test our hypothesis that the choice of a high-quality auditor is associated with whether a voluntary organization is an organization that collects money from the general public, and to investigate the determinants of auditor choice in the voluntary sector, we use the variable *Large* as our first proxy for high-quality auditors. *Large* is a dummy variable reflecting auditor choice. It takes the value 1 if the organization is audited by one of the Big 4 audit firms or BDO, and 0 if not. *Large* is chosen as a quality measure as the audit firm BDO qualifies as an industry specialist in most of this market, is the fourth largest audit firm in Norway and audits almost as many of the organizations in our sample as the Big 4 firms combined (19.6% vs. 24.1%).

In additional analyses, we use *Big4* and *IndustrySpecialist* (i.e. BDO) as proxies for high-quality auditors. When measuring the variable *IndustrySpecialist*, we build on both prior research such

⁹ Observations without an auditor are blank on this variable irrespective of whether the organization in question has chosen not to have an auditor or whether information is just missing in the database. It is not possible for us to determine whether these observations have an auditor.

as Palmrose (1986) and Craswell et al. (1995), who classify industry specialists based on client revenue, and Beattie et al. (2001) and (Harris et al., 2019), who use a count-based method, when we measure industry specialist in our sample.¹⁰ We also identify the industry specialist based on the same measures for voluntary organizations in our sample. BDO is the industry specialist also in the majority of the industries and for the group of voluntary organizations as a whole, but we see from table 2, panel A, that there are a few smaller industries in our sample in which one of the Big 4 firms qualifies as the industry leader. In the largest industries, untabulated findings show that BDO is the consistent industry leader, i.e. the industry leader over the entire sample period in industry numbers 10, 12, 16, 17, 18 and 19. We investigate this issue in additional analyses, reported in table 6. In our main analyses, *IndustrySpecialist* is a dummy taking the value 1 if the auditor is BDO and 0 otherwise. *Big4* is also a dummy variable taking the value 1 if the auditor is one of the Big 4 firms and 0 otherwise.

As discussed in our hypothesis development section, a potentially higher need for better advice or someone to blame (scapegoat-theory) to protect the organization's reputation in fundraising organizations than in non-fundraising organizations may have an impact on auditor choice. To measure fundraising voluntary organizations we use a dummy, *Fundraising*, that takes the value 1 if the organization is listed at The Norwegian Control Committee for Fundraising and 0 if the organization is not listed.

To investigate whether prior findings on determinants of auditor choice in the for-profit sector are transferable to smaller organizations in the voluntary sector, we build in particular on Knechel et al. (2008) and Niskanen et al. (2010) when specifying the right-hand-side of our model. We also build on the prior research in the voluntary sector, in particular (Harris et al.,

¹⁰ As of 31.12.2020, BDO has market share of 19.6% based on count and 29.7% based on client revenue. The largest Big 4 firm has a market share of 6.8% (KPMG) and 17.4% (Deloitte), respectively. The industry grouping made is in accordance with the Standard of Industrial Classification 2007 (SIC 2007), see <https://www.ssb.no/en/klasse/klassifikasjoner/6>.

2019) and Hay and Davis (2004). Knechel et al. (2008) distinguishes between the external and the internal value of an audit. The external value arises from reduced external agency costs caused by information asymmetry and interest conflicts between different stakeholders (such as shareholders, donors and creditors) and the organizational shareholders and organizational leadership. As organizations grow in complexity, agency conflicts may also arise between the organizational leaders and the subordinates and agency costs may diminish if an audit is conducted. These aspects of agency relationships are likely to have an impact on auditor choice also in smaller voluntary organizations and will be tested by our model.

According to principal-agency theory and in line with findings from prior research (e.g. Hay & Davis, 2004; Niskanen et al., 2010), an organization's debt to asset ratio is likely to influence auditor choice as choosing a high-quality auditor may lower the organization's agency costs and may be used as a signal to creditors of high financial reporting quality. Even though signaling to donors through the financial statements may be difficult in smaller voluntary organizations, such signaling is possible towards creditors. We include the variable *DebtRatio* in our model.

Knechel et al. (2008) finds that the decision to engage an international audit firm depends upon firm complexity. To control for internal complexity, we include the variables *subsidiaries* and *subdivisions* in our model as internal agency costs are likely to be higher in more complex organizations, and we expect that these organizations are more likely to choose a high-quality auditor. *Subsidiaries* is a dummy variable that equals 1 if the organization has subsidiaries, and 0 if not. *Subdivisions* is measured as the number of subdivisions in the organization. In our robustness tests, following Knechel et al. (2008), we also use the variables *RevenueGrowth* and *InvRec* to control for complexity. *RevenueGrowth* is measured as the percentage change in revenue from year t-1 to year t. *InvRec* is measured as the ratio of inventory and receivables to total assets.

Control variables

Because we include two different organizational forms in the sample, we also control for possible effects by including a dummy variable, *OrgForm*, which takes the value 1 if the organization is a foundation and 0 if the organization is a club or an association.

With the variable *lnTotalAssets*, we control for size, and in accordance with Knechel et al. (2008) and Niskanen et al. (2010), we use the natural logarithm of total assets.

Even though voluntary organizations do not have profit as a goal, financial health may have an impact on their auditor choice decision. Variables that control for this potential impact is included in prior research on auditor choice in the public sector (Harris et al., 2019). We also include these control variables to make our findings more comparable to findings in the for-profit sector. To control for the impact of an organization's financial health on the auditor choice decision, see for instance Harris et al. (2019), we include the variables *CurrentRatio* (measured as the ratio of current assets to current liabilities) , *ROA* (measured as net income divided by lagged total assets) and *LOSS* (measured as a dummy variable that equals 1 if net income is negative and zero if not).

Whether the client is located in a city may also affect auditor choice (Hope et al., 2012). Not all municipalities have a high-quality firm, and the likelihood that there is a high-quality firm in the municipality is higher if it is classified as a city. By contrast, high-quality firms may not necessarily choose to audit voluntary organizations in cities as they have other clients that they choose to prioritize, and this effect may have an impact on auditor choice. Given these concerns, we include the control variable *City* which takes the value 1 if the organization (client) is located in a city, and 0 if not. We control for year- and industry- fixed effects by including year- and industry dummies in the regression. Variable definitions are included in the appendix.

Hay and Davis (2004) suggests that organizations that use much of their revenues on salaries/wages may need to engage a high-quality auditor to avoid loss of management control. We do not have information about the size of wages in our sample, and we include the variable *OperatingMargin*, measured as the ratio of operating income to total revenue, as a control variable.

The variables *DebtRatio*, *CurrentRatio*, *OperatingMargin*, and *ROA* are winsorized at the 1st and 99th percentiles. We adjust for within-cluster correlation and heteroscedasticity by calculating the standard errors using the Huber-White Sandwich Estimator, clustered at the organization level (Guedhami et al., 2014; Niskanen et al., 2010; Petersen, 2009).

4. Findings

Descriptive statistics

[Insert table 2 here]

In table 2, we present descriptive statistics on auditor choice in the sample by year and industry. In panel A, the table shows the number of organization-years in the sample that are audited by the different Big 4 firms, BDO and small audit firms in the different industries included in the sample. The number of fundraising organization-years are shown in parentheses. We see from the table that there are four large industry groups in the sample: group 16 with education, including different types of not-for-profit schools, group 17 with human health and social work activities, group 18 with arts, entertainment and recreation, including sports clubs, museums and festivals, and group 19 with other service activities, including different membership organizations, interest groups and religious organizations. Based on count, BDO is the industry leader in all these groups. In panel B, the table shows the number of organizations that are audited by the different Big 4 firms, BDO and small audit firms in the different years included

in the sample with number of fundraising voluntary organizations in parentheses. Using the Mann Whitney U test, we test whether the large audit firms audit a higher proportion of fundraising voluntary organizations than the small audit firms, compared to non-fundraising voluntary organizations. Z-scores from the test are reported in the final column of the table. The proportion audited by the large firms are found to be significantly higher in all sample years (significance level of 1%). The results of these univariate tests give some support for our hypothesis.

Table 3, panel A, presents descriptive statistics for the whole sample, while panel B, reports descriptive statistics on fundraising voluntary organizations and non-fundraising voluntary organizations separately. We see that the use of a high-quality auditor (i.e. a large audit firm) is much more common among the group of fundraising voluntary organizations. 66% of the fundraising voluntary organizations have employed a large auditor while the corresponding number among the non-fundraising voluntary organizations is 42%. Fundraising voluntary organizations are on average larger (*lnTotalAssets*: 9.77 vs. 8.84) and more complex (*Subsidiaries*: 0.19 vs. 0.06, *Subdivisions*: 5.69 vs. 0.93) compared to non-fundraising voluntary organizations. Regarding the financing structure, fundraising voluntary organizations have on average lower levels of debt ratio (*DebtRatio*: 0.36 vs. 0.50) and higher levels of current ratio (*CurrentRatio*: 10.05 vs. 6.74). Regarding financial performance, no clear picture emerges. While fundraising voluntary organizations on average have higher return on assets (*ROA*: 0.12 vs. 0.07), they also report losses more frequently (*LOSS*: 0.36 vs. 0.31).

Panel C of table 3 reports the correlations among our variables. The correlation between *Fundraising* and *Large* is positive and significant, providing some preliminary support for our hypothesis. The highest correlation is between *OperatingMargin* and *ROA* (0.49) and *OperatingMargin* and *LOSS* (-0.49) for Pearson correlations and between *ROA* and *LOSS* (-0.81) and *ROA* and *OperatingMargin* (0.81) for Spearman correlations. Since all these variables

are calculated using net income or a component of net income, high correlation between these variables is not surprising. However, none of these variables have Variance Inflation Factors (VIF) higher than 1.5, suggesting that there is no severe multicollinearity in our model. Our results are also robust to excluding any of these three variables from the model.

[Insert table 3 here]

Test of hypothesis and model

Our hypothesis states that fundraising voluntary organizations are more likely to choose a high-quality auditor than do non-fundraising voluntary organizations. We test this by regressing *Large* on test and control variables as specified in equation (1) in section 3. The results from this test are reported in table 4.¹¹ The coefficient on *Fundraising* ($\beta_1=0.921$, z-value=3.81) is positive and significant at the 1% level. This supports our hypothesis and suggests that fundraising voluntary organizations are more likely to choose a high-quality auditor compared to organizations that are non-fundraising.

From the analysis reported in table 4, we see that the variables *DebtRatio* ($\beta_3=0.335$, z-value=2.34, and *Subsidiaries* ($\beta_4=0.817$, z-value=2.60) are positive and significant at the 5% and 1% level, respectively. This suggests that more leveraged and more complex organizations are more likely to be audited by a high-quality auditor. The control variable *lnTotalAssets* ($\beta_2=0.260$, z-value=6.12) is positive and significant at the 1% level, and the control variable *LOSS* ($\beta_8=-0.178$, z-value=-2.18) is negative and significant at the 5% level, suggesting that larger organizations are more likely to be audited by a high-quality auditor and organizations

¹¹ In table 4, the no. of observations in this test is 7,611 which is less than the total sample of 7,665. This is because STATA drops all observations (i.e. 54 observations) in two industry groups due to lack of variation in the outcome variable in these industry groups. To make sure that this does not influence any inferences, we have also run the regression with all 7,665 observations by (1) excluding the industry group variable and (2) reassigning the observations from the excluded industry groups to another industry group. The results hold and are qualitatively the same (untabulated).

reporting losses are less likely to be audited by a high-quality auditor. The remaining control variables are not significant in this regression.

[Insert table 4 here]

Robustness tests

We perform several tests to examine the robustness of the findings of our hypothesis test. First, we employ a propensity score matching design. Summary statistics in table 3 reveal that fundraising voluntary organizations and non-fundraising voluntary organizations differ on many characteristics including size, financing, and complexity. These are variables that may also influence auditor choice. Even though we control for these variables in the main regression, we examine whether our results are robust to matching on these variables instead. We use a propensity score matching design and match observations from fundraising voluntary organizations with observations from organizations that are not fundraising. We match on all control variables in equation (1), including year- and industry-fixed effects (DeFond et al., 2015). We use a probit model to obtain propensity scores with *Fundraising* as the outcome variable so that the propensity scores reflect the likelihood of being a fundraising organization. We use nearest neighbor matching without replacement (Hope et al., 2020) and limit the matching to observations within the common support of both groups (Bonacchi et al., 2019). Our matched sample consists of 523 observations from fundraising voluntary organizations and 523 observations from non-fundraising voluntary organizations.¹² The results from this test are reported in table 5, panel A. As we can see from this table, our main results hold in the propensity score matched sample.

¹² In table 5, the no. of observations in this test is 1,013. This is because STATA drops all observations (i.e. 33 observations) in one industry group due to lack of variation in the outcome variable in this industry group. To make sure that this does not influence any inferences, we have also run the regression with all 1,046 observations by (1) excluding the industry group variable and (2) reassigning the observations from the excluded industry group to another industry group. The results hold and are qualitatively the same (untabulated).

[Insert table 5 here]

Some of the clubs and associations in our sample are not required to engage an auditor, suggesting that they have voluntarily engaged an auditor. Motivations for auditor choice may differ based on whether the organization is required to have an auditor, and this may affect auditor choice as well. Consequently, we examine whether our results hold for firms that are *required* to engage an auditor. It is not possible to identify which particular organizations in our sample have voluntarily chosen to be audited. Hence, we test our hypothesis in a subsample consisting only of the foundations in our sample because all of these are required to have their accounts audited. The results from this test are reported in table 5, panel B, and we see that our main results hold in this subsample as well. Thus, our main results are not likely to be confounded by organizations that voluntarily choose to engage an auditor. We also test our hypothesis in a sample consisting of all organizations with total assets larger than 23 million NOK since these organizations are also required to have their accounts audited. Untabulated findings show that our main results hold in this subsample.

Our test variable *Fundraising* is based on information from The Norwegian Control Committee for Fundraising. We do not have data on whether some of the organizations in the sample have not been listed at The Norwegian Control Committee for Fundraising during the period of our analysis.¹³ As a robustness test, we test the hypothesis on the last year of the period, i.e. 2020. The findings from this test are reported in table 5, panel C, and they show that our main results hold using only the subsample from 2020.

¹³ We have also visited the internet homepage of all organizations that are classified as fundraising voluntary organizations in our sample to examine the purpose of the organization. We identify six organizations that only to some extent collect money from the general public. In untabulated robustness tests, we (1) run the analysis without these organizations and (2) reclassify these organizations to the zero category, and our results hold.

Most organizations in our sample are small. There are a few medium sized and larger organizations in the sample though with almost 600 million NOK in total revenues for the largest 1% of organizations. To make sure that the larger organizations in the sample do not drive our findings, we also test our hypothesis on a subsample where the largest organizations are excluded. For this purpose, we use the EU definition of small firms and exclude firms with more than 100 million NOK (Approximately 10MEUR) in total revenues.¹⁴ The results from this regression are reported in table 5, panel D. The results are in line with our main results, suggesting that our main results are not driven by the largest organizations.

We also perform several robustness tests to assess further that our results are not caused by differences in size and complexity between fundraising and non-fundraising voluntary organizations. First, we perform an additional propensity score matching on a subsample of observations of smaller firms (i.e. firms with less than 100 million NOK in total revenues). We use the same matching technique as described above in this subsample of smaller firms which is already more equal in size than the main sample. This matched sample consists of 381 observations from fundraising voluntary organizations and 381 observations from non-fundraising voluntary organizations.¹⁵ There are no significant differences in our control variables across fundraising and non-fundraising voluntary organizations in this matched sample; this suggests that the groups are equal in size and complexity. We find that our main results still hold, and *Fundraising* is positive and significant at the 5% level in this sample, see table 5, panel E. Second, we include the variable *InvRec* as an additional proxy for complexity

¹⁴ The EU definition of small firms is based on both staff headcount and either total revenues or balance sheet total European Commission. (n.d.). *Internal Market, Industry, Entrepreneurship and SMEs*. Retrieved 26/02/22 from https://ec.europa.eu/growth/smes/sme-definition_en. We do not have data on staff headcount for most of the observations, so we must rely on total revenues or balance sheet only. Using balance sheet total (i.e. less than 100 million NOK) instead of total revenues yields similar results (untabulated).

¹⁵ In table 5, the no. of observations in this test is 742. This is because STATA drops all observations (i.e. 20 observations) in one industry group due to lack of variation in the outcome variable in this industry group. To make sure that this does not influence any inferences, we have also run the regression with all 762 observations by (1) excluding the industry group variable and (2) reassigning the observations from the excluded industry group to another industry group. The results hold and are qualitatively the same (untabulated).

and our results hold. These results are reported in table 5, panel F. Third, we include the variable *RevenueGrowth* as an additional control variable for complexity and our results still hold. The results from this test are reported in table 5, panel G.

In our main analysis, we include variables reflecting the organizations financial health, such as *CurrentRatio*, *ROA*, and *OperatingMargin*. The reasons for including these variables are explained in our section on model development. However, some may argue that such variables make less sense conceptually in a sample of voluntary organizations. To make sure that our choice of including these variables does not influence our results, we test our hypothesis without these variables in the regression as well. These results are reported in table 5, Panel H, and we see that our main results still hold.

We also test the robustness of our results by the following untabulated tests: First, descriptive statistics in table 2 show that fundraising voluntary organizations are not represented in all the industry groups. We perform a robustness test where we exclude observations from industry groups without fundraising voluntary organizations (i.e. sports clubs are for instance excluded) and find that our results hold. Second, a substantial portion of the missing observations are caused by missing observations on net income. We perform a robustness test without the variables *ROA* and *LOSS* (which makes use of net income) to maximize the number of observations. The number of observations in this test is 8, 351, and we find that our results hold. Third, we winsorize the variable *Subdivisions*, and our results hold. Fourth, we run separate regressions for all the years in the sample. Our main finding holds in all these regressions. Finally, we exclude extreme observations instead of winsorizing them, and our result holds.

Additional analyses

As discussed in the theory section of this paper, voluntary organizations may have several motivations for engaging a high-quality auditor. A high-quality auditor may provide the

organization with better advice and, for instance, improve cost control and reduce the risk of fraud. A high-quality auditor may then protect the organization from a reputational loss through high-quality auditing and advice. A competing view is that some voluntary organizations may want to engage a high-quality auditor as a scapegoat so that they have someone to blame in the event of a reputational loss, assuming in this way to minimize their own reputational loss (e.g., “We did everything right. We even chose a high-quality auditor to make sure we did everything right”). The main analysis does not distinguish between these two competing explanations on why fundraising voluntary organizations may want to engage a high-quality auditor.

In the additional analyses, we attempt to distinguish better these two competing explanations. Following categorization in prior research, BDO is the industry-leader in this market, which was one of our arguments for including BDO as one of the high-quality auditors in the first place. An industry specialist is likely to be more qualified to provide a high-quality audit given superior knowledge of the industry. Thus, we expect that if the first rationale (i.e. a high-quality auditor may protect the organization from reputational loss through better auditing and advice) dominates, fundraising voluntary organizations are more likely to choose the industry specialist (i.e. BDO). Yet if the scapegoat rationale (i.e. engaging a high-quality auditor to have someone to blame and thus minimize own reputational loss) dominates, fundraising voluntary organizations are more likely to hire a Big 4 auditor. The Big 4 auditors are not industry specialists in this sample, but they are likely to be more well-known and consequently have a superior reputation among the general public. Consequently, even though the Big 4 firms may not offer superior knowledge compared to the industry leader BDO, they may work better as potential scapegoats because of their being well-known as high-quality auditors.

We test these explanations by performing several regressions with *IndustrySpecialist* and *Big4* as the outcome variables. Table 6 reports the results from these regressions. In panel A, we run the regression in the full sample with *IndustrySpecialist* as the outcome variable. As

Fundraising is not significant in panel A, we do not find evidence that suggests fundraising voluntary organizations are more likely to choose the industry specialist when compared to all other audit firms (i.e. both Big 4 and non-Big 4 firms).

[Insert table 6 here]

In panels B and C, *Big4* is the outcome variable. In panel B we run the regression in the full sample, while in panel C we exclude small audit firms; this means that in panel C we compare Big 4 firms to the industry specialist. *Fundraising* is positive and significant in both panels; this suggests that fundraising voluntary organizations are more likely to choose a Big 4 audit firm than a non-Big 4 audit firm (including the industry specialist in the zero category) and they are more likely to choose a Big 4 audit firm than the industry specialist (panel C). In general, our additional analyses indicate that fundraising voluntary organizations are more likely to choose a well-known audit firm than the industry specialist: This indicates that the second rationale (i.e. hiring a high-quality auditor to have someone to blame and thus minimize one's own reputational loss) may dominate over the first rationale (i.e. a high-quality auditor may protect the organization from reputational loss through better auditing and advice).

In these additional analyses, we have treated the voluntary sector as one industry and categorized BDO as the industry leader. Table 2 not only demonstrates that BDO is by far the most used auditor among the voluntary organizations, but also that BDO is not the most used auditor among all the smaller industry groups. Given this, we rerun the last test (i.e., Big 4 vs. Industry specialist as reported in table 6, panel C) in a subsample where we include only those industry groups where BDO is the consistent industry leader. Given the focus on the industry leader at industry group level in this test, we further include only those industry groups where

both fundraising and non-fundraising voluntary organizations are represented (i.e., industry groups 10, 17, and 19). In this subsample, the coefficient on *Fundraising* is positive and significant at the 10% level. The results from this test are reported in table 6, panel D.

5. Discussion and conclusion

Prior research on auditor choice in the voluntary sector of the economy is sparse. Because one main difference between organizations in the voluntary sector and firms in the for-profit sector is how activities are financed, we are particularly interested in whether smaller voluntary organizations that collect money from the general public (i.e. fundraising voluntary organizations) differ from other voluntary organizations in their choice of auditors. Hay & Davis (2004) finds that incorporated societies where a large proportion of the revenue comes from members are more likely to engage a high-quality auditor than do other similar organizations. We extend this finding by investigating another type of voluntary organizations that may have incentives to engage a high-quality auditor; namely organizations that collect money from the general public. In a sample of voluntary foundations, clubs, and associations, we find support for our hypothesis that fundraising voluntary organizations are more likely to engage a high-quality auditor than other voluntary organizations. As prior research from the voluntary sector (Beattie et al., 2001; Verbruggen et al., 2015) shows that engaging a Big N auditor is costly, our finding indicates that fundraising voluntary organizations have more to gain from making this choice than do other voluntary organizations.

Several competing theories can be used to explain this finding. To better understand why these organizations choose to engage a high-quality auditor, we investigate whether fundraising voluntary organizations are more likely to engage a Big 4 auditor, an industry specialist auditor (not Big 4) and whether they are more likely to choose a Big 4 auditor over an industry specialist (non-Big 4) when compared to voluntary organizations that are not fundraising. Our findings

indicate that organizations that collect money from the general public (i.e. *fundraisers*) are more likely to engage a Big 4 firm, but they are not more likely to engage the industry specialist. In addition, analysis of a sample restricted only to organization-years with Big 4 and the industry specialist suggests that fundraising voluntary organizations are more likely to choose a Big 4 auditor than the industry specialist compared to organizations that are not fundraising. These findings may indicate that what the organizations are after is more likely to be a potential scapegoat than a desire for superior advice. However, we cannot rule out the possibility that the fundraising voluntary organizations may not view the industry leader as superior to the Big 4 firms in terms of providing superior advice. Whereas some prior research finds that donors do not typically use financial statements when making their donation decisions, Kitching (2009) suggests that charities may use a Big N auditor to signal that their financial statements are of high quality. We argue that our setting with relatively small voluntary organizations provides an arena where it is less likely that donors use the financial statements for decision-making purposes compared to other settings. Consequently, we have to look for other explanations for auditor choice than just signaling. Due to our study's design, we cannot completely rule out the possibility that the financial statement was actually used by donors in their decision-making process: This is a limitation to our study. We leave it for further research to provide more evidence on this topic.

We also investigate whether prior findings from the private sector on determinants of auditor choice are transferrable to voluntary organizations. We find that as previously examined in the for-profit sector, voluntary organizations that choose a high-quality auditor are larger, more leveraged and more complex than organizations that do not choose a high-quality auditor. Organizations that experience a loss are less likely than organizations that do not experience loss to choose high-quality auditor. In accordance with Knechel et al. (2008), these findings

indicate that the value of an audit also in the voluntary sector is related to agency costs caused by external and internal complexity.

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Appendix. Variable definitions

Variable	Definition
<u>Dependent Variables:</u>	
<i>Large</i>	Dummy variable that equals 1 if the financial statements are audited by one of the large audit firms, 0 otherwise
<i>Big4</i>	Dummy variable that equals 1 if the financial statements are audited by one of the Big 4 audit firms, 0 otherwise
<i>IndustrySpecialist</i>	Dummy variable that equals 1 if the financial statements are audited by BDO, 0 otherwise
<u>Independent variables:</u>	
<i>Fundraising</i>	Dummy variable that equals 1 if the organization is approved for private donations by The Norwegian Control Committee for Fundraising, and 0 otherwise
<i>lnTotalAssets</i>	Natural logarithm of total assets (NOK thousands)
<i>DebtRatio</i>	The ratio of total debt to total assets
<i>Subsidiaries</i>	Dummy variable that equals 1 if the organization has subsidiaries, 0 otherwise
<i>OrgForm</i>	Organizational form, dummy variable that equals 1 if the organization is a foundation, and 0 if it is a "FLI" (clubs and associations)
<i>CurrentRatio</i>	The ratio of current assets to current liabilities
<i>ROA</i>	Net income in year t divided by the book value of total assets in year $t-1$
<i>LOSS</i>	Dummy variable that equals 1 if the firm has negative earnings, 0 otherwise
<i>Subdivisions</i>	Number of subdivisions in the organizations
<i>City</i>	Dummy variable that equals 1 if the organization is located in a city, and 0 if not
<i>OperatingMargin</i>	The ratio of operating income to total revenues
<i>RevenueGrowth</i>	The percentage change in revenue from year $t-1$ to year t
<i>InvRec</i>	The ratio of inventory and receivables to total assets

Tables

Table 1. Sample selection

Foundations, clubs, and associations with more than 1 million NOK in total revenues in 2020	3 019
- Foundations, clubs, and associations that are not registered in the database of voluntary organizations	1 639
= Voluntary foundations, clubs, and associations in the database	1 380
Organization-year observations in the database for the period 2011-2020	13 800
- Missing information on auditor or does not have an auditor	4 629
- Missing information on other variables	1 506
= Organization-year observations in sample	7 665

Table 2 Descriptive statistics on auditor by industry and year

Panel A: Total number of organization-years (Fundraising organization-years in parentheses)

Industry Group	EY	Deloitte	PWC	KPMG	BDO	Large	Small	Total	z-value
1: Agriculture, forestry, and fishing	0	0	1	14	9	24	24	48	NA
8: Rescue services	0	3 (3)	0	0	1 (1)	4 (4)	0	4 (4)	NA
9: Accommodation and food service activities	0	10	0	8	2	20	47	67	NA
10: Information and communication	5	6 (3)	0	4	31 (1)	46 (4)	33	79 (4)	-1.728
12: Real estate activities	19	4	1	13	34	71	78	149	NA
13: Professional, scientific and technical activities	10 (10)	18	2	8 (8)	12 (2)	50 (20)	0	50 (20)	NA
14: Administrative and support service activities	17	0	10	20	6	53	67	120	NA
16: Education	42	42	43	34	119	280	349	629	NA
17: Human health and social work activities	73 (6)	163 (35)	148 (31)	90 (34)	328 (94)	802 (200)	844 (66)	1646 (266)	-9.428
18: Arts, entertainment and recreation	112	134	89	147	328	810	1042	1852	NA
19: Other service activities	169 (30)	108 (34)	99 (17)	184 (24)	631 (26)	1191 (131)	1830 (118)	3021 (249)	-4.444
Total	447 (46)	488 (75)	393 (48)	522 (66)	1501 (124)	3351 (359)	4314 (184)	7665 (543)	-10.914

Panel B: Total number of organization (Fundraising organization)

	EY	Deloitte	PWC	KPMG	BDO	Large	Small	Total	z-value
2011	45 (6)	45 (8)	38 (6)	52 (10)	99 (11)	279 (41)	333 (22)	612 (63)	-3.277
2012	41 (2)	46 (6)	37 (4)	50 (6)	117 (10)	291 (13)	333 (28)	624 (41)	-2.874
2013	42 (2)	47 (7)	39 (5)	47 (7)	133 (12)	308 (33)	364 (15)	672 (48)	-3.304
2014	45 (5)	40 (3)	39 (4)	48 (6)	136 (5)	308 (23)	371 (11)	679 (34)	-2.676
2015	46 (6)	38 (2)	38 (3)	49 (6)	146 (8)	317 (25)	407 (13)	724 (38)	-2.807
2016	45 (5)	45 (5)	40 (4)	50 (6)	146 (7)	326 (27)	423 (11)	749 (38)	-3.511
2017	39 (4)	44 (3)	36 (3)	54 (5)	152 (8)	325 (23)	426 (14)	751 (37)	-2.376
2018	51 (6)	59 (15)	39 (6)	56 (7)	178 (18)	383 (52)	505 (27)	888 (79)	-4.264
2019	49 (6)	60 (14)	41 (6)	57 (7)	194 (22)	401 (55)	547 (28)	948 (83)	-4.624
2020	44 (4)	64 (12)	46 (7)	59 (6)	200 (23)	413 (52)	605 (30)	1018 (82)	-4.392
Total	447 (46)	488 (75)	393 (48)	522 (66)	1501 (124)	3351 (359)	4314 (184)	7665 (543)	-10.914

This table presents descriptive statistics on auditor choice for our sample. Panel A presents total number of organization-years (and organization years for the subgroup of fundraising voluntary organizations) audited by each of the large audit firms separately and as a group (i.e., Large), for small audit firms, total (all audit firms). These statistics are presented for each industry group separately. Panel B presents total number of organizations (and organizations for the subgroup fundraising voluntary organizations) audited by each of the large audit firms separately and as a group (i.e., Large), for small audit firms, total (all audit firms). These statistics are presented for each year separately. The column z-value reports the z-value from a Mann–Whitney U test of the difference in Large vs Small for fundraising and non-fundraising voluntary organizations.

Table 3. Summary statistics

Panel A: Descriptive statistics for the whole sample

	N	Mean	Standard deviation	p25	p50	p75	Min	Max
<i>Large</i>	7665	0.44	0.50	0.00	0.00	1.00	0.00	1.00
<i>Fundraising</i>	7665	0.07	0.26	0.00	0.00	0.00	0.00	1.00
<i>lnTotalAssets</i>	7665	8.91	1.81	7.63	8.82	10.16	0.00	15.22
<i>DebtRatio</i>	7665	0.49	0.42	0.19	0.41	0.68	0.00	2.74
<i>Subsidiaries</i>	7665	0.07	0.25	0.00	0.00	0.00	0.00	1.00
<i>OrgForm</i>	7665	0.57	0.49	0.00	1.00	1.00	0.00	1.00
<i>CurrentRatio</i>	7665	6.97	17.27	1.34	2.36	4.93	0.13	135.22
<i>ROA</i>	7665	0.07	0.29	-0.02	0.02	0.11	-0.67	1.80
<i>LOSS</i>	7665	0.32	0.47	0.00	0.00	1.00	0.00	1.00
<i>Subdivisions</i>	7665	1.27	7.46	0.00	0.00	0.00	0.00	172.00
<i>City</i>	7665	0.80	0.40	1.00	1.00	1.00	0.00	1.00
<i>OperatingMargin</i>	7665	0.03	0.20	-0.02	0.02	0.08	-0.93	0.70

Panel B: Descriptive statistics for fundraising vs. non-fundraising voluntary organizations

	Mean		Median		Standard deviation		No. of observations		Difference in mean
	Fundraising	Non-fundraising	Fundraising	Non-fundraising	Fundraising	Non-fundraising	Fundraising	Non-fundraising	
<i>Large</i>	0.66	0.42	1.00	0.00	0.47	0.49	543	7 122	-0.24***
<i>lnTotalAssets</i>	9.77	8.84	9.74	8.79	2.53	1.72	543	7 122	-0.93***
<i>DebtRatio</i>	0.36	0.50	0.29	0.42	0.28	0.43	543	7 122	0.14***
<i>Subsidiaries</i>	0.19	0.06	0.00	0.00	0.39	0.24	543	7 122	-0.13***
<i>OrgForm</i>	0.57	0.58	1.00	1.00	0.50	0.49	543	7 122	0.01
<i>CurrentRatio</i>	10.05	6.74	2.95	2.32	22.47	16.78	543	7 122	-3.31***
<i>ROA</i>	0.12	0.07	0.03	0.02	0.42	0.28	543	7 122	-0.05***
<i>LOSS</i>	0.36	0.31	0.00	0.00	0.48	0.46	543	7 122	-0.04**
<i>Subdivisions</i>	5.69	0.93	0.00	0.00	23.87	3.86	543	7 122	-4.76***
<i>City</i>	0.83	0.80	1.00	1.00	0.38	0.40	543	7 122	-0.03*
<i>OperatingMargin</i>	0.02	0.03	0.01	0.02	0.19	0.20	543	7 122	0.00

Panel C: Pearson and Spearman correlation matrix

		v1	v2	v3	v4	v5	v6	v7	v8	v9	v10	v11	v12
<i>Large</i>	v1	1.00	0.12***	0.22***	0.04***	0.18***	-0.04***	-0.06***	-0.00	-0.03***	0.13***	-0.01	-0.02
<i>Fundraising</i>	v2	0.12***	1.00	0.09***	-0.09***	0.13***	-0.00	0.09***	0.00	0.02**	0.09***	0.02*	-0.03***
<i>lnTotalAssets</i>	v3	0.23***	0.13***	1.00	-0.04***	0.38***	-0.28***	-0.01	-0.05***	-0.06***	0.42***	0.10***	0.05***
<i>DebtRatio</i>	v4	0.02*	-0.09***	-0.16***	1.00	-0.03***	0.02	-0.75***	-0.15***	0.06***	0.07***	-0.04***	-0.08***
<i>Subsidiaries</i>	v5	0.18***	0.13***	0.43***	-0.05***	1.00	-0.18***	-0.06***	-0.01	-0.03***	0.33***	0.07***	-0.01
<i>OrgForm</i>	v6	-0.04***	-0.00	-0.28***	0.03***	-0.18***	1.00	-0.00	0.01	0.03***	-0.09***	-0.22***	0.03**
<i>CurrentRatio</i>	v7	-0.03***	0.05***	-0.01	-0.27***	-0.04***	0.01	1.00	0.17***	-0.09***	-0.09***	0.05***	0.15
<i>ROA</i>	v8	-0.01	0.04***	-0.07***	-0.14***	-0.02*	0.04***	0.10***	1.00	-0.81***	-0.04***	-0.01	0.81***
<i>LOSS</i>	v9	-0.03***	0.02**	-0.07***	0.10***	-0.03**	0.03***	-0.04***	-0.46***	1.00	-0.02*	0.01	-0.71***
<i>Subdivisions</i>	v10	0.06***	0.16***	0.27***	0.02	0.30***	-0.09***	-0.04***	-0.02*	-0.01	1.00	0.03**	-0.02
<i>City</i>	v11	-0.01	0.02*	0.11***	-0.04***	0.07***	-0.22***	-0.02**	-0.01	0.01	0.05***	1.00	-0.07***
<i>OperatingMargin</i>	v12	-0.01	-0.00	0.03**	-0.06***	-0.01	0.02**	0.09***	0.49***	-0.49***	-0.01	-0.03***	1.00

This table reports summary statistics. Panel A presents descriptive statistics: mean, standard deviation, the 25th, the 50th, and the 75th percentiles, minimum and maximum values for the whole sample. Panel B presents descriptive statistics: mean, median, standard deviation and the number of observations for the subgroups (1) Fundraising voluntary organizations, *Fundraising*=1, and (2) organizations that are not fundraising, *Fundraising*=0. It also shows the difference in mean between the groups. Panel C provides the Pearson's correlation matrix (lower triangle) and Spearman's correlation matrix (upper triangle) among the test and control variables. The variables are defined in Appendix. * (**) *** indicates significance at the 10 (5) 1 percent levels.

Table 4. Main results

	Large	
	<i>coefficients</i>	<i>z-stat</i>
<i>Fundraising</i>	0.921 ^{***}	(3.81)
<i>lnTotalAssets</i>	0.260 ^{***}	(6.12)
<i>DebtRatio</i>	0.335 ^{**}	(2.34)
<i>Subsidiaries</i>	0.817 ^{***}	(2.60)
<i>OrgForm</i>	0.064	(0.44)
<i>CurrentRatio</i>	-0.001	(-0.39)
<i>ROA</i>	0.099	(0.76)
<i>LOSS</i>	-0.178 ^{**}	(-2.18)
<i>Subdivisions</i>	-0.010	(-1.09)
<i>City</i>	-0.172	(-1.00)
<i>OperatingMargin</i>	-0.354	(-1.36)
<i>Year fixed effects</i>	Yes	
<i>Industry fixed effects</i>	Yes	
<i>Constant</i>	-2.261 ^{**}	(-2.30)
<i>N</i>	7611	
<i>adj. R²</i>		
<i>pseudo R²</i>	0.063	

This table presents the coefficients and corresponding z-statistics of regressing *Large* on the test and control variables using logistic regression, testing our hypothesis. The variables are defined in Appendix. Fixed effects on year and industry are included. The z-statistics are adjusted for within-cluster. * (**) *** indicates significance at the 10 (5) 1 percent levels using two-tailed tests.

Table 5. Robustness tests

	Panel A: PSM Large		Panel B: Foundations only Large		Panel C: 2020 only Large		Panel D: Small organizations only Large	
	<i>coefficients</i>	<i>z-stat</i>	<i>coefficients</i>	<i>z-stat</i>	<i>coefficients</i>	<i>z-stat</i>	<i>Coefficients</i>	<i>z-stat</i>
<i>Fundraising</i>	0.862***	(3.28)	1.003***	(3.12)	0.811***	(3.11)	0.847***	(3.12)
<i>lnTotalAssets</i>	0.313***	(4.11)	0.199***	(3.59)	0.312***	(6.14)	0.234***	(5.11)
<i>DebtRatio</i>	0.035	(0.08)	0.197	(1.06)	0.366*	(1.71)	0.289**	(2.01)
<i>Subsidiaries</i>	0.832*	(1.89)	0.364	(0.57)	0.792**	(2.17)	0.384	(1.06)
<i>OrgForm</i>	0.375	(1.30)			0.047	(0.31)	0.059	(0.40)
<i>CurrentRatio</i>	-0.001	(-0.21)	-0.001	(-0.16)	0.001	(0.16)	-0.001	(-0.35)
<i>ROA</i>	0.321	(1.27)	0.017	(0.11)	0.309	(1.20)	0.088	(0.70)
<i>LOSS</i>	-0.133	(-0.68)	-0.070	(-0.68)	-0.503**	(-2.34)	-0.163**	(-1.96)
<i>Subdivisions</i>	0.032	(1.30)	0.047	(1.04)	0.012	(0.71)	0.006	(0.21)
<i>City</i>	-0.731**	(-2.15)	-0.222	(-1.09)	-0.314*	(-1.73)	-0.154	(-0.89)
<i>OperatingMargin</i>	-0.715	(-1.32)	-0.144	(-0.43)	-1.112**	(-2.26)	-0.331	(-1.28)
<i>Year fixed effects</i>	Yes		Yes		Yes		Yes	
<i>Industry fixed effects</i>	Yes		Yes		Yes		Yes	
<i>Constant</i>	-2.117**	(-2.01)	-0.946	(-1.01)	-2.296*	(-1.91)	-2.023**	(-2.07)
<i>N</i>	1013		4376		1012		7161	
<i>pseudo R²</i>	0.149		0.050		0.087		0.036	

	Panel E: PSM small organizations only		Panel F: Additional control variable (<i>InvRec</i>)		Panel G: Additional control variable (<i>RevenueGrowth</i>)		Panel H: Without CurrentRatio, ROA and OperatingMargin	
	Large		Large		Large		Large	
	<i>coefficients</i>	<i>z-stat</i>	<i>coefficients</i>	<i>z-stat</i>	<i>coefficients</i>	<i>z-stat</i>	<i>coefficients</i>	<i>z-stat</i>
<i>Fundraising</i>	0.661**	(2.22)	0.907***	(2.69)	0.910***	(3.76)	0.920***	(3.81)
<i>lnTotalAssets</i>	0.259***	(2.72)	0.259***	(4.93)	0.262***	(6.12)	0.258***	(6.09)
<i>DebtRatio</i>	-0.408	(-0.77)	0.375**	(2.22)	0.335**	(2.32)	0.342**	(2.48)
<i>Subsidiaries</i>	-0.147	(-0.32)	0.838**	(2.29)	0.814***	(2.59)	0.828***	(2.63)
<i>OrgForm</i>	0.111	(0.35)	0.073	(0.43)	0.064	(0.44)	0.060	(0.41)
<i>CurrentRatio</i>	-0.002	(-0.35)	-0.005	(-1.17)	-0.001	(-0.39)		
<i>ROA</i>	-0.227	(-0.76)	0.090	(0.54)	0.088	(0.65)		
<i>LOSS</i>	-0.447**	(-2.03)	-0.104	(-1.06)	-0.176**	(-2.15)	-0.131*	(-1.89)
<i>Subdivisions</i>	0.078	(1.24)	-0.012	(-1.60)	-0.010	(-1.10)	-0.010	(-1.07)
<i>City</i>	-0.963**	(-2.39)	-0.062	(-0.32)	-0.178	(-1.04)	-0.166	(-0.97)
<i>OperatingMargin</i>	-0.181	(-0.33)	0.165	(0.50)	-0.337	(-1.26)		
<i>InvRec</i>			0.217	(0.39)				
<i>RevenueGrowth</i>					-0.017	(-0.26)		
<i>Year fixed effects</i>	Yes		Yes		Yes		Yes	
<i>Industry fixed effects</i>	Yes		Yes		Yes		Yes	
<i>Constant</i>	-0.742	(-0.55)	-2.477**	(-2.39)	-2.264**	(-2.30)	-2.254**	(-2.33)
<i>N</i>	742		4768		7582		7611	
<i>pseudo R²</i>	0.093		0.059		0.063		0.062	

This table presents the coefficients and corresponding z-statistics of regressing *Large* on the test and control variables using a propensity score matched sample (Panel A), a sample of foundations only (Panel B), a sample of observations from the year 2020 only (Panel C), in a sample with small organizations only (Panel D), a propensity score matched sample of small organizations only (Panel E), including complexity (*InvRec*) as an additional control variable (Panel F), using *RevenueGrowth* as an additional control variable (Panel G), and excluding the variables *CurrentRatio*, *ROA*, and *OperatingMargin* (Panel H), using logistic regression. The variables are defined in Appendix. Fixed effects on year and industry are included. The z-statistics are adjusted for within-cluster correlation. * (**) *** indicates significance at the 10 (5) 1 percent levels using two-tailed tests.

Table 6. Additional analyses

	Panel A: Full sample		Panel B: Full sample		Panel C: Sample with Big4 and industry specialist only		Panel D: Sample with Big4 and industry specialist only in reduced sample	
	<i>IndustrySpecialist</i>		<i>Big4</i>		<i>Big4</i>		<i>Big4</i>	
	<i>coefficients</i>	<i>z-stat</i>	<i>coefficients</i>	<i>z-stat</i>	<i>coefficients</i>	<i>z-stat</i>	<i>coefficients</i>	<i>z-stat</i>
<i>Fundraising</i>	0.040	(0.13)	0.905***	(3.59)	0.540*	(1.65)	0.557*	(1.66)
<i>lnTotalAssets</i>	0.130**	(2.55)	0.225***	(4.81)	0.075	(1.14)	0.083	(1.02)
<i>DebtRatio</i>	0.114	(0.64)	0.323**	(1.96)	0.127	(0.56)	0.391	(1.21)
<i>Subsidiaries</i>	0.088	(0.27)	0.623**	(2.03)	0.300	(0.81)	0.146	(0.33)
<i>OrgForm</i>	-0.299*	(-1.74)	0.352**	(2.10)	0.559**	(2.50)	0.397	(1.40)
<i>CurrentRatio</i>	0.001	(0.19)	-0.003	(-0.74)	-0.004	(-0.79)	-0.008	(-1.45)
<i>ROA</i>	-0.029	(-0.19)	0.154	(1.01)	0.082	(0.41)	0.230	(0.88)
<i>LOSS</i>	-0.203*	(-1.94)	-0.045	(-0.46)	0.083	(0.66)	0.125	(0.77)
<i>Subdivisions</i>	0.001	(0.07)	-0.012*	(-1.72)	-0.011	(-0.62)	-0.017	(-0.64)
<i>City</i>	-0.308	(-1.48)	0.041	(0.21)	0.250	(0.96)	0.156	(0.46)
<i>OperatingMargin</i>	-0.273	(-0.82)	-0.214	(-0.72)	-0.003	(-0.01)	-0.107	(-0.19)
<i>Year fixed effects</i>	Yes		Yes		Yes		Yes	
<i>Industry fixed effects</i>	Yes		Yes		Yes		Yes	
<i>Constant</i>	-2.380*	(-1.78)	-2.995***	(-3.08)	-0.651	(-0.45)	-1.867	(-1.57)
<i>N</i>	7665		7665		3351		2039	
<i>adj. R²</i>								
<i>pseudo R²</i>	0.026		0.065		0.044		0.039	

This table presents the results from additional analyses. Panel A presents the results of regressing *IndustrySpecialist* on test and control variables using logistic regression. Panel B and C presents the results of regressing *Big4* on test and control variables using logistic regression. Panel B includes the full sample, while in Panel C, the sample consists of Big 4 audit firms and the industry specialist only (i.e. the high-quality audit firms). Panel D reruns the regression from panel C in a reduced sample including only industries were BDO is consistent industry leader and both fundraising and non-fundraising voluntary organizations are represented. The variables are defined in Appendix. Fixed effects on year and industry are included. The z-statistics are adjusted for within-cluster correlation. * (**) *** indicates significance at the 10 (5) 1 percent levels using two-tailed tests.