



## Different approaches to fraud risk assessment and its implications for audit planning: ISA versus isa less-complex entities

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### Abstract

Auditors are responsible for identifying and resolving material misstatements in financial statements based on relevant auditing standards. However, the International Standard on Auditing (ISA), commonly used as a reference, is often considered too complex for micro, small, and medium-sized enterprises (SMEs). In 2024, the International Auditing and Assurance Standards Board (IAASB) issued ISA for Less-Complex Entities (ISA LCE), which aims to provide audit standards tailored to entities with lower complexity levels. This study aims to examine the role of auditors in the assessment of fraud risks through two different auditing standard approaches, International Auditing Standards and Less Complex Entities (LCE)-based International Auditing Standards. The study uses a mixed-method approach. The quantitative approach employs from a survey of 85 auditors from various Public Accounting Firms (PAFs) and uses multiple regression analysis to examine auditor readiness in implementing ISA LCE audit standards. The results of the multiple regression analysis are triangulated by the qualitative research approach in the form of personal interviews with PAFs' partners dan supervisors to explore how ISA LCE audit practices prevent fraud. The findings show that the application of ISA-LCE is more relevant for SMEs, considering their simple organizational structures and uncomplicated transactions. This standard also allows auditors to conduct audits more efficiently in terms of time and cost without sacrificing quality. The implementation of ISA-LCE also enhances transparency and accountability in SMEs' financial reporting. Reporting with ISA LCE is also more direct and focuses on key findings without requiring excessive detail. These findings offer valuable insights for academics, practitioners, and regulators regarding the implementation of ISA LCE standards in SMEs.

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## 1. Introduction

Audit quality has become a significant public concern due to the failures of large companies, such as the cases of Enron, Swissair (Switzerland), Kirch Media (Germany), Daiwa Bank, Sumitomo Corporation (Japan), Bank of China (China), Daiwoo (Korea), and Lernout and Hauspie (Belgium) (Arora & Singh, 2020). Periodic crises and similar malpractice events raise questions about auditor objectivity and negatively impact public trust. In this context, the audit process is expected to produce value derived from impartial audit procedures that are free from the influence of human subjectivity, so that it can provide high-quality financial reports (Ahmet, Ekşi, & Burcu, 2022).

Although audit standards continue to change periodically, there is still limited understanding of how auditors implement these new standards (Alotaibi & Alnesafi, 2023). Standard setters generally expect companies to be able to adopt new standards quickly and accurately (Ardianto et al., 2023). However, the prevalence of financial reporting fraud among large companies has led to sharp criticism of the public accounting profession. Auditors are often perceived as contributing to misleading information, causing harm to various stakeholders, both internal and external to the company (Aida, 2021). In Indonesia, the majority of Public Accounting Firm (PAF) clients consist of small and medium-sized entities (SMEs) or micro, small, and medium enterprises (MSMEs). Despite this, there is a significant disparity between the number of public accountants and the growing needs of the MSME sector, which requires quality audit reports and assistance with tax reporting.

The large number of cases of financial reporting fraud by large companies has resulted in the public accounting profession receiving a lot of criticism, so the quality of the audits provided needs to be re-assured for their effectiveness (Yang, Jiao, & Buckland, 2017). This is because auditors are considered to play a role in providing false information so that many parties feel disadvantaged, both internal and external stakeholders of the company (Aida, 2021). Currently, most potential clients of Public Accounting Firms (PAFs) are small and medium entities or Micro, Small and Medium Enterprises (MSMEs). The availability of public accountants in Indonesia is not comparable to business units, especially in the MSME sector. According to Jamain (2018) while the potential for a career as a public accountant in Indonesia is vast with 203 PAFs registered with the Financial Services Authority (FSA) the number of practicing public accountants remains relatively small. Data from the Association of Chartered Certified Accountants (ACCA) indicates that Indonesia is facing a professional accountant shortage, with only 452,000 accountants available for the country's vast economic landscape.

To effectively address challenges in fraud risk control, auditors must possess a comprehensive understanding of professional auditing standards (Fortvingler & Szívós, 2016). Regardless of the location where audit services are performed, auditors are obligated to adhere to generally accepted professional standards during audit engagements. In an effort to uphold public trust in the auditing profession, the International Auditing and Assurance Standards Board (IAASB) establishes globally recognized, high-quality standards for audit and assurance engagements. To support this mission, the IAASB has introduced the International Standards on Auditing (ISA), which have been instrumental in auditing and reviewing historical financial information. However, these auditing standards issued by the IAASB have certain limitations as they primarily focus on large and complex corporate entities. Unfortunately, entities with complex scopes often exhibit a high-risk profile, indicating weak governance practices and vulnerability to corporate failures (International Association for Accounting Education & Research (IAAER), 2021). Despite periodic revisions to the ISA by the IAASB, ensuring their applicability to all audit issues within the business scope, including those concerning Less-Complex Entities (LCE) such as small and micro businesses, remains a topic of ongoing discussion among practitioners and academics (International Auditing and Assurance Standards Board, 2022).

Internationally, several countries have expressed divergent positions regarding adoption. For instance, Sri Lanka and Bangladesh have fully adopted ISA for LCEs. Finland is considered a pioneer in its adoption and implementation process, actively supporting its integration to streamline audits of small entities. Meanwhile, the United Kingdom, Canada, Ireland, Australia, Belgium, and Denmark have opted not to adopt the standard, citing reasons such as risks of creating a two-tier profession, insufficient reduction in audit effort, and potential declines in audit quality due to reduced explanatory material and scalability concerns. Furthermore, the Indonesian Institute of Public Accountants (IAPI) reported that out of 700,000 companies, including micro entities that submit Annual Tax Returns (SPT), only 30,000 utilize accounting services (CNN Indonesia, 2019). In comparison, other Southeast Asian countries, such as Thailand, have much higher adoption rates of professional accountants, with 62,000 of its 680,000 operating companies employing them. This disparity highlights a significant gap in Indonesia's ability to meet the auditing needs of its businesses, particularly MSMEs. The Center for Financial Profession Development (PPPK) also reported that as of January 21, 2019, the number of active public accountants was only 1,368. In addition, according to data from the Financial Services Authority, the number of Accounting Firms in Indonesia registered with the Financial Services Authority as of May 20, 2020 was only 781 (Otoritas Jasa Keuangan, 2020). This imbalance has led to challenges in maintaining audit quality for MSMEs. A study using the International Federation of Accountants (IFAC) framework revealed that audit quality in Indonesia achieved only 36.55%, falling short of

global standards (Nurfitriyani, 2021). These conditions underscore the need for Public Accounting Firms to operate efficiently while ensuring high-quality audits to retain clients.

Audit engagements with smaller and less complex entities come with unique challenges, including limited internal controls, potential management override, and inadequate documentation systems. Moreover, cost-efficiency pressures often hinder auditors from delivering timely and cost-effective services, further exacerbating public mistrust in the profession (Alotaibi & Alnesafi, 2023). This mistrust is fueled by cases of audit failures, where companies receiving unqualified opinions later faced bankruptcy. Although the rules on economic regulation set out in the Sarbanes-Oxley Act of 2002 in the United States were designed to strengthen auditor control, audit quality remains a major concern for stakeholders (Beisland, Mersland, & Strøm, 2015; Francis & Wang, 2008; Hope, Kang, Thomas, & Yoo, 2008). Therefore, considering the importance of the role and high level of trust in the public accounting profession, auditors must pay more attention to their audit assessments (Aida, 2021). To support this, the IAASB sets high-quality international standards in the audit and assurance process that can strengthen public confidence in the audit profession. In fulfilling this objective, the IAASB issues and develops ISA that can be applied in audit engagements and reviews of historical financial information.

Given these concerns, the IAASB has issued global auditing standards, such as the ISA, to strengthen public confidence in audit practices. However, these standards are designed primarily for large and complex entities, leaving a gap in relevance for smaller, less complex entities (LCEs). To address this, the IAASB introduced the ISA LCE in June 2021 (Lakoma, Murphy, & Toothill, 2024). The ISA LCE is tailored to the unique needs of LCEs, offering simplified, risk-based approaches for auditing smaller businesses. This new standard aims to achieve consistent audit quality globally while being cost-effective and easier to implement (Holm & Laursen, 2007). The ISA for LCE is a standalone global auditing standard designed specifically for smaller and less complex businesses and organizations. Built on the foundation of the International Standards on Auditing, audits performed using this standard provide the same level of assurance for eligible audits: Reasonable assurance. The standard is effective for audits beginning on or after December 15, 2025 for jurisdictions that adopt or permit its use. This new draft standard is very important because it represents a new era for the IAASB and provides further feedback for stakeholders (International Auditing and Assurance Standards Board, 2019). By adopting this LCE audit standard, it is expected to have a significant impact on auditors and the work they do. For countries like Indonesia, where MSMEs represent 99% of all businesses and contribute significantly to employment and GDP (Darmasari, 2021; Revindo & Gan, 2018) the adoption of ISA LCE is particularly relevant.

ISA is a series of standards set by IAASB and is internationally recognized as a reference in conducting audits. This standard is designed to be applied to various entities, including those with a large scale to complex public companies. On the other hand, ISAs-LCE was developed to meet the audit needs of smaller and simpler entities, where the audit challenges and risks faced are not as great as those in larger entities. For a country like Indonesia, where many business entities are micro, small, and medium enterprises (MSMEs), the relevance of ISAs-LCE is necessary (Nurfitriyani, 2021). LCE not only provides important contributions to the world economy but more specifically to Indonesia. Especially now, the Indonesian economy is in the recovery phase from the pandemic so that strengthening the MSME sector is currently very fundamental (Mola, 2021).

The importance of this comparative research cannot be underestimated. With a diverse population of entities in Indonesia, especially MSMEs which are the pillars of the economy, the implementation of appropriate audit standards is very important in determining the success and growth of this business sector (Abdallah, Ghanem, & Mahboub, 2024). On the one hand, the use of ISA can offer more assurance in terms of the fairness of financial statements, but on the other hand, the application of ISA to non-complex entities is often perceived as a heavy administrative and financial burden. Therefore, a deep understanding of the effectiveness and efficiency of each audit standard is very important. In addition, this study is also important in facing the challenges faced by auditors in Indonesia. In practice, many auditors face difficulties in applying ISA to entities that do not have high complexity. Often, auditors are forced to perform procedures that may not be relevant to the conditions faced by the entity. This can result in inefficient use of resources and increase audit costs, which ultimately burdens small entities. Therefore, a comparative understanding between these two standards can help in formulating better recommendations for audit practices in Indonesia.

This study explores the practical implications of using ISA and ISA LCE in Indonesia's unique business landscape. It aims to address the challenges auditors face in applying ISA to less complex entities and evaluate the efficiency and effectiveness of these standards. By comparing these frameworks, this research seeks to provide actionable recommendations for improving audit practices in Indonesia, fostering trust in financial reporting, and supporting economic growth. Overall, the research related to the comparison between the use of ISA and ISA-LCE in Indonesia is not only beneficial for auditors and audited entities, but also contributes to the development of better audit practices in the country. The results of this study are expected to provide substantive recommendations in designing an audit framework that is more effective, efficient, and relevant to the needs of the Indonesian economy which continues to grow. Thus, it is expected to create general trust in financial reports, support economic growth, and create a more conducive investment climate.

## **2. Literature Review**

### *2.1. International Auditing Standards (ISA Versus ISA LCE)*

International Standards on Auditing (ISAs) are designed to be applied to a wide range of entities with differing circumstances and sizes, including LCEs. Approximately 130 jurisdictions have adopted or partially adopted the ISAs. As a member of the European Union (EU), the UK was subject to the Audit Directive of 17 May 2006, which enforced the use of ISAs for all statutory audits to be performed in the EU. In December 2019, immediately before the formal ending of EU membership in January 2020, the FRC confirmed the list of standards operating at that time would be effective for audits of financial statements for periods commencing on or after 15 December 2019.

Public accounting firm in England draws on three isomorphic mechanisms (Coercive, mimetic and normative) that may lead to institutional isomorphism (DiMaggio & Powell, 1983). The EU legislation is an example of coercive isomorphism when organizations are required by law to comply with the ISAs. As a result of the UK leaving the EU, the FRC acknowledged that the adoption of ISAs was largely in the public interest and advised local authorities to continue to follow the ISAs in the UK (Normative isomorphism). Public accounting firm for small entities have increasingly become more distinct from the more complex auditing arrangements of the private sector and the larger local public authorities (Rönkkö et al., 2024). LCE in England tend to share common auditing arrangements amongst each other, and they are becoming similar to one another largely through a process of mimetic isomorphism.

Nonetheless, many auditors struggle to apply ISAs to small LCEs. With the increasing complexity in the activities of audited entities and capacity challenges requiring correspondingly more complex auditing standards, the IAASB decided to establish a separate standard specifically for auditing LCEs entitled the "International Standard on Auditing (ISA) for Audits of Financial Statements of Less Complex Entities (ISA for LCE)". Recognizing the urgent demand for a separate, less complex standard for LCEs (Fraser, 2010) the standard was published in December 2023 and is effective for audits of financial statements.

Auditing Standards regulate the standards used by practitioners when conducting audits of historical financial statements. Auditing standards are prepared and developed by the International Federation of Accountants (IFAC) which aims to develop high-quality international standards in the areas of auditing and assurance, public sector accounting, ethics, and education for professional accountants and to support their adoption and use (Liudmila, 2020). To support this target, IFAC has established a number of bodies and committees to develop international standards and guidelines, one of which is the International Auditing and Assurance Standards Board (IAASB). The IAASB was established to improve the quality and uniformity of practice worldwide and strengthen public confidence in the audit profession globally (Brown, Dennis, Dickens, Higgs, & Schaefer, 2019). The adoption of international standards set by IFAC has changed the audit standards in the Public Accountant Professional Standards (SPAP) of March 31, 2011, which have been used based on US GAAS, to SPAP based on ISA.

So far, the IAASB has continued to focus its efforts on maintaining the quality and scalability of audit standards for entities of all sizes and meeting the needs of stakeholders (International Auditing and Assurance Standards Board, 2019). There are several influences that drive changes in the auditor environment. These influences can impact the audit of all entities, including LCEs (International Auditing and Assurance Standards Board, 2022). In this case, the IAASB always pays attention to the need for ISA to be applied to all entities, starting from those with simpler and easier natures and conditions, such as less complex entities, to more complex entities (Nurfitriyani, 2021). The term less-complex entities was adopted because the IAASB believes that international audit standards for LCEs need to focus on the complexity of an entity rather than its size. Therefore, in 2017, the IAASB held a conference in Paris to discuss considerations of issues related to the audit of MSMEs, and proposed a new audit standard that applies to less complex entities such as MSMEs (Mola, 2021). This is because less complex entities make an important contribution to the economy throughout the world (Nurfitriyani, 2021). In line with this, increasingly complex organizational structures and transactions need to be addressed through the development and revision of ISAs.

The International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE) is a stand-alone standard, based on the core requirements of ISA issued by the IAASB for comment on July 23, 2021. The term Less Complex Entities (LCE) was adopted because the IAASB is of the view that ISA for LCE should focus on the complexity of the entity rather than its size. Therefore, ISA for LCE, by design, does not address complex matters or circumstances and is not permitted to be used for audit characteristics other than qualitative aspects of LCE.

The IAASB continues to monitor developments to ensure that ISAs can be scaled to be used for audits of all entities, regardless of their size or complexity (Brown et al., 2019). However, the operating and reporting environment is becoming more complex and continues to evolve. In addition, through inspection results it was found that audit quality showed high-profile company failures, which were often associated with more complex entities. This contributed to the latest ISA revisions such as ISA 540 and ISA 315, where the revisions aimed to make international standards more relevant to changes in the business world and support consistent audit quality (Simnett, 2012). Unfortunately, with this revision there are growing concerns regarding the complexity and understanding of this standard and its application to LCE audits (Liudmila, 2020). Therefore,

some stakeholders question whether ISA remains relevant and can be applied effectively and efficiently to all audited entities ([International Auditing and Assurance Standards Board, 2022](#)).

The IAASB has developed the ISA – LCE as a “standalone” standard, independent of the ISAs and therefore does not require direct reference to or application of material in the ISAs. Therefore, the overall decision for the audit engagement is to determine whether the ISA for LCE is appropriate based on the nature and circumstances of the entity. For example, the auditor should consider situations where a less complex entity has complex accounting estimates that are not addressed by the proposed ISA LCE; the auditor should apply the full ISA rather than using the ISA for LCE together with the requirements of ISA 540 (Revised) to supplement the requirements not addressed in the ISA for LCE when planning and performing the audit of that entity. Even if there is any doubt, the auditor should revert to the full ISA.

### *2.2. Fraud Risk Assessment based on ISA Versus ISA-LCE*

Globalization has brought numerous advantages to society through technological advancements that streamline business processes. However, this drive for profitability and competitiveness has led companies to resort to questionable practices, seeking maximum gains while minimizing losses. As a consequence, fraudulent activities have become a pervasive issue, encompassing corruption, asset misuse, and financial statement manipulation. These fraudulent behaviors pose a significant challenge for auditors as they are often intricate and difficult to uncover through standard financial audits.

An auditor's competence in detecting fraud refers to their capability to recognize and articulate instances of fraudulent behavior, ultimately uncovering misrepresented financial information. The responsibilities of auditors regarding fraud are clearly outlined in ISA, particularly ISA 240. This standard mandates that external auditors must evaluate and identify risks of material misstatement due to fraud, obtain sufficient and appropriate audit evidence in relation to those risks, and implement suitable audit procedures in response to any fraud identified or suspected during the audit engagement.

The effectiveness of auditors in uncovering fraud is significantly shaped by their approach to assessing fraud risk. This assessment involves the process of identifying, analyzing, and evaluating an organization's exposure to potential fraud threats. As part of their responsibilities, auditors are expected to carry out a comprehensive fraud risk assessment, which forms the foundation for developing audit procedures aimed at achieving reasonable assurance in detecting misstatements arising from fraud as well as other errors. Actively gathering information about areas in financial statements or operational processes that may be prone to fraudulent practices is essential. This approach aids in recognizing possible fraud schemes and determining appropriate preventive or corrective actions. Prior research has highlighted the positive influence of effective fraud risk assessment on the auditor's capacity to detect fraud ([Mulyono, Jaswadi, & Amerieska, 2021](#); [Rizki & Endraningtyas Dewi, 2017](#)).

Audit risk assessment is governed under the ISA, with particular emphasis on ISA 240, which defines the auditor's responsibilities in addressing fraud and error during audits of financial statements across all types of entities. The 2004 revision of ISA 240 was made to align it more closely with the audit risk model and to incorporate the core principles and key procedures of SAS 99, which focuses on the consideration of fraud in financial statement audits. The revised standards also integrate elements from other relevant ISAs, including ISA 315, which has been effective since 2014 and emphasizes the identification and evaluation of risks of material misstatement through an in-depth understanding of the entity and its environment. Additional revisions include standards such as ISA 330 and ISA 500, both of which were introduced in 2003.

### *2.3. Role of Audit and Governance in MSMEs*

Public accountants assess the work of internal auditors to determine the extent of their dependence on internal audit. Such dependence is also considered an area where internal auditors add value through reducing audit costs ([Krishnamoorthy, 2001](#); [Mihret, James, & Mula, 2010](#); [Morrill & Morrill, 2003](#)). Such cost-saving opportunities arguably create interest in other components of corporate governance, such as the board of directors and management, to promote internal and external audit cooperation ([Ghani, Jabal, Zandi, & Hye, 2022](#); [Mihret et al., 2010](#)).

The motivation to reduce external audit fees in an effort to reduce audit costs and maintain competitiveness in the audit services market motivates the external auditor's decision to rely on the work of internal auditors ([Morrill & Morrill, 2003](#)). In addition, internal auditors' closer knowledge of their organization may provide external auditors with the possibility to reduce audit risk. Thus, examining the internal-external audit relationship in diverse settings will yield useful insights of both academic and practical value for corporate governance. For example, in highly competitive external audit service markets, the degree of external auditors' dependence on the work of internal auditors may exceed those in less competitive markets. Previous empirical studies on the internal-external auditor relationship have been mostly in the context of developed economies. Thus, this relationship, its socio-economic and cultural backgrounds, and the implications that ensure it are largely under-researched in corporate governance settings in developing countries ([Mihret et al., 2010](#)).

The need to test the applicability of audit approaches to socio-economic and cultural settings different from those in which the approaches originated is recognized (Ritchie & Khorwatt, 2007). Haniffa and Cooke (2002) suggest that because environmental factors influence audit practices, techniques and approaches prescribed for use in developed economies may not be applicable to the same extent in countries with different socio-economic settings. The overall corporate governance arrangements arguably influence the nature of the relationship between audit mechanisms.

### **3. Materials and Methods**

This study uses a mixed methods approach, which combines qualitative and quantitative data to obtain a more comprehensive picture of the effectiveness of the two audit standards in the context of entities in Indonesia. Tashakkori and Teddlie (2003) suggest that mixed methods are superior to single approach designs in three ways. First, they can answer research questions that the other methodologies cannot. Second, mixed methods research provides better (stronger) inferences and finally, mixed methods provide the opportunity for presenting a greater diversity of divergent views. Thus, this study is able to provide a more comprehensive picture of the topic studied, including the effectiveness of audit standards in the context of entities in Indonesia. In this study, the emphasis is on a deep understanding of the application of International Standards on Auditing (ISA) and ISA for Less Complex Entities (ISA LCE), especially in the context of MSMEs.

Under the quantitative approach the study employs multiple regression analysis. This research was conducted by auditors at PAFs throughout Indonesia, which consisted of 465 PAFs registered as members of the Ministry of Finance and are still active. This study consists of four independent variables that reflect the readiness of auditors at PAFs to implement the ISA LCE audit standards, namely intellectual capital resources ( $X_1$ ), human resources ( $X_2$ ), financial resources ( $X_3$ ), and organizational resources ( $X_4$ ). Meanwhile, the dependent variable in this study is SME governance ( $Y$ ). Based on the four-lines-of-defence model, to precisely address this "deficiency" by assigning a specific role to external parties (Namely, external auditors and banking supervisors) in relation to the design of the internal control system, acknowledging that, although they remain outside the organization's boundaries, they constitute a vital element of assurance and governance systems. The types of data in this study are primary data. The source of this research data comes from the respondents' responses to the questionnaires distributed. The technique for collecting data in this study used a survey method with an instrument in the form of a questionnaire. Questionnaires were distributed directly to external auditors at public accounting firms in Indonesia. The development of the questions used in the questionnaire uses the question model in previous research, but the researcher will make adjustments according to the subject and object of the study.

One of the important components in this study is the collection of qualitative data through in-depth interviews. These interviews were conducted with nine informants from four different PAFs. The diverse representation of informants, including senior auditors, managers, and partners, provided valuable perspectives on the implementation of the two audit standards. Through these interviews, the researcher hopes to explore the opinions, experiences, and challenges faced by auditors in implementing ISA and ISA LCE in Indonesia. The main objective of the in-depth interviews is to explore the qualitative aspects of the implementation of the two audit standards. This study focuses on a number of issues, including the complexity of the audit process, the relevance of standards to the size and characteristics of the entity, and their impact on the quality of financial statements. With a thematic analysis approach, the researcher will identify consistent patterns and themes among the views of the informants, thus providing in-depth insight into the audit practices that occur in the field.

In line with qualitative data, this study also collects quantitative data through the distribution of questionnaires. However, this approach is carried out in a more structured and systematic manner. The questionnaire was distributed to 85 auditors from various PAFs throughout Indonesia, consisting of various levels of positions in the organization, including partners, managers, supervisors, senior auditors, and junior auditors. This questionnaire is designed in such a way as to evaluate the auditor's perspective on the implementation of ISA LCE and its impact on the audit quality of clients equivalent to MSMEs. Simple regression analysis is the statistical analysis method chosen to assess the relationship between the implementation of ISA LCE and auditors' perceptions of audit quality. This method allows researchers to identify factors that influence auditors' views, as well as assess how the implementation of simpler audit standards can contribute to improving audit quality in less complex entities. This quantitative data is expected to complement the qualitative analysis and provide a stronger empirical basis for the research results.

### **4. Discussion**

The results of this study provide a clear picture of the advantages and disadvantages of each audit standard in the context of entity audits in Indonesia. Through a mixed methods approach, qualitative research will provide in-depth insights into the practical challenges faced by auditors, while quantitative data will build stronger arguments regarding the effectiveness and benefits of each standard. The interview results revealed that auditors in Indonesia tend to apply the ISA-LCE audit standard. The main reason expressed by the informants is the characteristics of their clients, who are mostly from the MSME segment. Fundamentally,

ISA-LCE is specifically designed to meet the needs of simpler and less complex entities. This is relevant in the context of MSMEs which often have uncomplicated organizational structures, as well as limited and easier-to-understand transactions. One of the advantages of using ISA-LCE is the ease of implementing audit planning, implementation, and reporting procedures. In the interviews, most informants emphasized that the implementation of these procedures is more efficient, which leads to savings in time and resources. The use of ISA-LCE allows auditors to adjust audit activities to the specific needs of clients. In this context, standardization of audit procedures with a focus on MSMEs is very relevant because it can improve the quality of supervision and accountability in this sector.

In an increasingly competitive business world, cost and time effectiveness are two key factors that contribute to the success of MSMEs. The resource person highlighted that by implementing ISA-LCE, auditors can save audit costs for their clients. This can be a significant added value because MSMEs often operate with tight budget constraints. By adapting a simpler and more efficient approach to auditing, MSMEs can benefit without having to sacrifice service quality. Furthermore, the alignment of audit standards with the conditions and needs of MSMEs has the potential to increase stakeholder trust. In this context, auditors who implement ISA-LCE can more easily provide practical recommendations that can be implemented by MSMEs in their financial management, as a result, increasing transparency and accountability in financial reporting.

So far, auditors who handle clients of MSME-scale entities or equivalent to less-complex entities perform audit procedures based on guidelines from the Ministry of Finance (Financial Profession Development Center) and the Indonesian Institute of Public Accountants (IAPI) in the form of the ATLAS (Audit Tool and Linked System) application. Where the application has been used by almost all auditors in Indonesia in implementing Audit Standards and Public Accountant Professional Standards. In some cases, if the auditor finds a procedure that must be carried out in accordance with SA but cannot be applied to the client due to the nature of the company, the auditor will replace it with a relevant procedure. For example, according to N1, in ATLAS one way to conduct a risk assessment examination is to conduct an interview with the Those Charge with Governance (TCWG), but in general, companies in the MSME category do not have an organizational structure as complex as large companies, even only having an owner and several field employees. Therefore, they usually only need to interview the company owner to fulfill the procedure.

Based on the results of interviews with sources, auditors from various sample PAFs also provided opinions regarding the ISA-LCE implementation plan. N2 stated that because this standard has not been fully implemented and socialized, so if this audit standard is implemented, it is hoped that adequate socialization and clear description of the procedure have been provided, especially for the target entity, it must also be clear, so that auditors know what audit standards we must refer to and the reasons so that auditors can explain to clients. Similar opinions were also expressed by other auditors.

*"Before making a standard, we must first know the general picture of who is the intended recipient of this standard and what it is like, then adjust it and find alternatives that can be worked around so that we also, it's not that we don't want to implement the standard but it is like this" N2.*

*"Maybe the procedure can be simplified to suit the conditions in the field, so it's not like, for example, usually the mandatory procedure is ten out of ten, it's impossible to do all of them, maybe only five are mandatory or something like that" N3.*

The results of the risk assessment influence audit procedures. This is regulated in SA 330 regarding the auditor's response to assessed risks. In SA 330, the auditor is required to design and implement audit procedures based on the assessed risks of material misstatement. However, the results of the peer review program from AICPA in 2016 showed that one in ten PAFs failed to comply with SA 315 and SA 330 (Aditya, Hartanto, & Nugroho, 2018). The analysis of data obtained from the peer review revealed that misunderstandings in practice have a major impact on audit quality. Many auditors, especially those who audit small to medium scale entities, believe that the auditor can perform a quality audit without considering the risks of the client entity.

To address this issue, the auditor must perform alternative procedures in accordance with SA 315 and SA 330. These procedures involve gaining a thorough understanding of the client and their environment, including the internal control system. The auditor should identify client risks, including any significant risks, if applicable. Additionally, it is essential to document the correlation between the risk assessment and the procedures outlined in the audit plan. Throughout the engagement, regular reviews of audit risks and plans should be conducted. These measures ensure compliance with relevant auditing standards and enable the auditor to effectively address the problem at hand. A comprehensive understanding of the entity and its environment is crucial for conducting risk assessments and ensuring compliance with auditing standards. Procedures employed to gain this understanding encompass inquiries of management and other relevant personnel, analytical procedures, and observation and inspection. It is imperative for auditors to comprehend the client's nature of business, operations, and any unique circumstances such as specific laws and regulations that apply. Without this understanding, it becomes challenging to accurately assess the risks associated with the client.

*"In my personal opinion, the fraud risk assessment is part of the audit risk assessment. So as I explained earlier, that in the audit risk assessment process itself there are several procedures including general information and*

legality aspects of the Company, understanding the organizational structure and job descriptions, understanding the client's main business processes, understanding relevant regulations, understanding the business environment, business continuity analysis, understanding the process of preparing and compiling client financial statements, as well as analysis of fraud factors. So, this fraud factor analysis is a form of fraud risk assessment that we carry out. Where in this procedure we ascertain whether there is pressure, opportunity, and rationality that has the opportunity to trigger fraud in the company" N1.

The results of interviews with the auditors indicate that the risk assessment procedure is based on an important stage in the audit process, including the planning, implementation and reporting stages.

"Before that, before we came there, we already got some of the data that we requested beforehand, so we usually analyze it and then it also helps with the analysis of the financial reports. Is there any irregularities or not? That's the first step. I think you need to highlight what the business process here is. There are certain accounts that will become our focus of attention later to check before carrying out field work after getting the financial reports and some of the data begins to be analyzed and the analysis is supported by several forms, form a form b. There are some of our forms which we filled out too" N3.

Based on the provided explanation, it is critical to emphasize the significance of ISA 240, which pertains to fraud risk assessment. Interviews conducted with N1 revealed that the implementation of fraud risk assessment at PAF aligns with SA 240 and adopts the ATLAS framework. It involves several essential communication aspects with Those Charged with Governance (TCWG) and other relevant parties in relation to the auditor's responsibility for fraud in financial statement audits. This process aims to identify any pressures, opportunities, and rationalizations that could potentially trigger fraudulent activities within a company. N2 also emphasized that fraudulent actions are often discernible when conducting a comprehensive understanding of the client's entity and business processes.

From the results of distributing questionnaires to all PAFs in Indonesia, the data collected were 24 PAFs with 85 research respondents consisting of auditors with positions as partners, managers, senior auditors and junior auditors. This number of PAFs counted as respondents is not surprising because it is in line with the opinion of the International Federation of Accountants (IFAC) which states that PAF clients with small and medium entities mostly have a shortage of audit staff. Table 1 presents demographic information about survey respondents. As many as 54% of respondents are dominated by men. Meanwhile, almost 93% of the number of auditors in PAFs has less than 100 members or is in the third-tier category. The data in Table 1 also shows that most respondents are junior auditors and senior auditors with an average work experience of three years or less. This shows that junior and senior auditors in this research sample have a relatively short tenor.

Table 1. Demographics of respondents.

Description	Frequency	%
Gender		
Male	46	54%
Female	39	46%
Number of PAFs		
More than 400 people ( <i>First tier</i> )	2	2%
Between 100 - 400 people ( <i>Second tier</i> )	4	5%
Under 100 people ( <i>Third tier</i> )	79	93%
Positions		
Partner	11	13%
Manager	4	5%
Senior auditor	24	28%
Junior auditor	46	54%
Experiences (Year)		
1-3 years	50	59%
4-10 years	35	41%
> 10 years	10	12%

Based on Table 2 showing the results of the regression analysis, it can be seen that the independent variable, namely the implementation of the ISA-LCE audit standard, has a significant effect on audit quality. The regression coefficient of this variable is 0.593 with a p-value of 0.000, which means that the effect of this variable on audit quality is very significant at a significance level of 1%. This shows that the better the implementation of the ISA-LCE audit standard, the higher the audit quality produced by the auditor. The R<sup>2</sup> value of 0.742 shows that 74.2% of the variation in audit quality can be explained by the implementation of the ISA-LCE audit standard, while the rest (25.8%) is influenced by other variables not included in this model. This R<sup>2</sup> value is quite high, indicating that the regression model has good predictive power. In addition, the results of the F-test with a p-value of 0.006 also show that this regression model as a whole is significant at

the 1% level, meaning that this model can be used to explain the relationship between the implementation of the ISA-LCE audit standard and audit quality.

**Table 2.** Regression analysis.

Variables	Coeff.	p-value
Constants	6.282	0.036*
X <sub>1</sub> Implementation of ISA-LCE audit standards	0.593	0.000**
R <sup>2</sup>	0.742	
F-test	0.006*	

**Note:** \*. Significant coefficient at 0.05 and \*\*. Significant coefficient at 0.01.

Overall, the study demonstrates that the implementation of ISA-LCE significantly improves audit quality, especially for entities with relatively simple transactions and uncomplicated management structures, as commonly found in MSMEs. This finding aligns with prior research indicating that tailored audit standards can enhance the efficiency and relevance of audits in specific contexts. For instance, studies by [Lakoma et al. \(2024\)](#) and [Alia and Subli \(2024\)](#) similarly suggest that streamlined audit standards improve audit outcomes for smaller entities. However, the current study goes further by emphasizing the role of ISA-LCE in fostering public trust and accountability, which is a relatively underexplored aspect in the existing body of literature.

One key feature of ISA-LCE identified in this study is its risk-based approach, which directs auditors' attention to high-risk areas, enabling more efficient resource allocation. While this aligns with the principles of risk-based auditing discussed in prior ([Law, 2008](#)) the application of these principles in the MSME context has not been thoroughly explored. Unlike traditional ISAs, which are often deemed too rigid and resource-intensive for smaller entities, ISA-LCE provides a more flexible framework. This flexibility may explain why ISA-LCE is particularly effective for MSMEs, a conclusion that contrasts with findings in studies focusing on large entities where comprehensive ISAs are typically more suitable.

Another novel contribution of this study is the emphasis on the unique characteristics of MSMEs and how ISA-LCE accommodates these traits. While prior research ([Alia & Subli, 2024](#); [Haapamäki & Sihvonen, 2019](#)) has discussed the challenges MSMEs face in financial management, there has been limited focus on how audit standards specifically address these challenges. This study highlights how ISA-LCE's simpler and more targeted procedures enhance auditors' understanding of MSMEs, making the audit process more efficient without compromising quality. This contrasts with studies that argue for the universality of traditional ISAs, suggesting that a one-size-fits-all approach may not be optimal.

The study also addresses the broader implications of ISA-LCE on public trust and accountability. Previous studies ([Haapamäki and Mäki \(2023\)](#)) have underscored the role of audit standards in enhancing transparency, but the direct link to public trust in the MSME sector remains underexplored. This research bridges that gap by demonstrating how ISA-LCE fosters greater confidence among stakeholders, including customers and suppliers, who heavily rely on the credibility of financial reports. This finding diverges from earlier studies that focus primarily on investor perceptions in larger corporations, offering new insights into the stakeholder dynamics of smaller entities.

Despite its contributions, the study acknowledges challenges in the practical implementation of ISA-LCE, particularly concerning auditor training and adaptation. This aligns with [Haapamäki and Mäki \(2023\)](#) which highlights the steep learning curve associated with new audit standards. However, this study uniquely emphasizes the need for continuous education tailored to ISA-LCE, contrasting with studies that advocate broader, less specific training programs.

In conclusion, while the study's findings are largely consistent with existing literature, they provide a fresh perspective by focusing on the distinct needs of MSMEs and the unique benefits of ISA-LCE. By addressing the gaps in prior research and offering practical implications, this study contributes to a deeper understanding of how tailored audit standards can enhance audit quality, accountability, and trust in the MSME sector. Future research should continue to explore these themes, particularly the long-term social and economic impacts of ISA-LCE implementation.

## 5. Conclusions

This research indicated that risk assessment is a structured method used to evaluate the acceptability of risks within an organization, forming a fundamental component of the audit process. This approach is widely implemented in risk-based audits, particularly those carried out by PAFs. The identification and evaluation of risks serve as the basis for designing audit procedures. Further studies have shown that fraud risk assessments conducted by PAFs are in accordance with SA 240 and incorporate the ATLAS framework. These assessments also highlight the importance of communicating certain elements related to fraud responsibilities to Those Charged with Governance (TCWG) and other relevant stakeholders. The examination focuses on identifying pressures, opportunities, and rationalizations that could lead to fraud within a company. Similar findings were corroborated by other sources, emphasizing that clients' comprehension of the entity and business processes is instrumental in reporting fraudulent acts. The study also captured auditors' opinions on the implementation

plan for ISA-LCE across various PAFs in Indonesia. Auditors expressed the need for proper socialization and clear procedure descriptions, especially concerning the intended entities, as the full implementation and understanding of this standard have not yet been achieved. This clarity is essential to ensure auditors know the specific audit standards to reference and provide thorough explanations to clients.

From an academic perspective, this study makes several contributions to the academic literature on audit standards in Indonesia. It enriches the understanding of the practical application of ISA-LCE, particularly in the MSME context, and highlights client characteristics as a critical factor in determining the effectiveness of audit standard implementation. Furthermore, the study underscores the value of integrating qualitative and quantitative methods (Mixed-methods research) to provide a more holistic view of audit standard implementation and its outcomes. This approach bridges the gap between theoretical insights and real-world practices, offering a deeper understanding of how tailored audit standards can enhance audit effectiveness.

From a practical perspective, the findings offer actionable insights for auditors and stakeholders. The study underscores the importance of adopting audit standards suited to the specific needs of clients, especially those in the MSME sector. ISA-LCE, with its simplified and efficient procedures, provides an effective solution for auditors working with small and medium-sized entities. Additionally, the efficiency of ISA-LCE contributes to lower audit costs, making high-quality audit services more accessible to MSMEs without compromising accountability or transparency. These practical insights encourage policymakers and practitioners to support the broader adoption of ISA-LCE and similar standards that cater to less complex entities.

To bridge the gap between theory and practice, this study demonstrates how adapting global audit frameworks to local business environments can create tangible improvements in audit outcomes. It also highlights the importance of incorporating client-specific factors into the design and application of audit procedures, thereby ensuring that standards remain relevant and effective across diverse business contexts. Future research should aim to build on these findings by focusing on several critical areas. First, broader sample coverage is essential to gain a comprehensive understanding of ISA-LCE's effectiveness; this could be achieved by including auditors from various scales of Public Accounting Firms and diverse client types across Indonesia. Second, a sectoral analysis should be conducted to evaluate how ISA-LCE can be applied in more complex industries, identifying its adaptability and any limitations beyond the MSME context. Third, it is important to explore the challenges in audit standard implementation, delving into the difficulties auditors face when applying different audit standards in Indonesia and assessing their impact on audit quality across various sectors. Lastly, future studies should investigate stakeholder trust and client satisfaction by analyzing how the adoption of ISA-LCE influences the confidence of stakeholders and the satisfaction levels of audited entities, providing deeper insights into its broader implications for the economy and society. By addressing these areas, future research can provide richer insights into the applicability, benefits, and challenges of ISA-LCE and other audit standards, contributing to the continuous improvement of audit practices in Indonesia and beyond.

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