The Revealed Demand for Auditors Materiality Disclosures

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This study addresses two research questions related to a recent change in audit regulations in the UK, which now requires auditors to publicly disclose in the audit report the materiality thresholds they apply when conducting an audit. First, we examine whether the information needs of stakeholders influence the choice of auditor materiality threshold. We find that the firm's reliance on debt financing and the extent of insider shareholding influence auditor materiality threshold choice, but analyst following does not. Second, we examine whether investors use the materiality threshold information when assessing the reliability of earnings for equity valuation purposes. We find that the difference between the earnings multiple of low materiality firms and that of high materiality firms decreases after the disclosure of auditor applied materiality levels consistent with lower materiality firms benefiting from such disclosures, thereby improving the perceived reliability of their financial statements.