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Can Financial Assurance Affect The Success Of Equity Crowdfunding Capital Campaigns?

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New research finds that having a CPA firm review a startup's financial statements can significantly improve the success of an equity crowdfunding campaign and the future prospects of the company, according to a study forthcoming in [The Accounting Review](#).

With equity crowdfunding (ECF), an open call is made through an online platform to solicit small investments from a large pool of investors. The SEC requires ECF companies to provide financial statements to potential investors. The financial statements can be accompanied by certifications from company management, or reviews and audits by independent CPA firms.

ECFs seeking to raise smaller amounts of capital (<\$107,000) have the option to choose between management certifications or CPA assurances. Startups raising larger funds through an ECF are required to have either a review or audit by an independent CPA firm. A review of financial statements is smaller in scope than an audit. An audit typically includes tests of internal controls, inspection of assets, confirmation of balances, and other forms of verification.

In a study titled "The Role of Assurance in Equity Crowdfunding" researchers poured over 1,212 ECF capital campaigns between 2016 and 2018 and examined the relation between financial statement assurance and the success of the ECF campaign, as well as the startup's future viability. The study is authored by Evisa Bogdani and Monika Causholli from the University of Kentucky and W. Robert Knechel from the University of Florida.

"Over the last few years there has been a lot of innovation in the area of startup financing including ECF. Worldwide ECF has seen tremendous growth, especially in the U.K. and Australia. The U.S. took a more cautionary approach. In the U.S., The Jumpstart Our Business Startups (JOBS) Act of 2012 recognized the importance of ECF for innovation and job growth, especially for early-stage companies. In 2015, the SEC issued Regulation Crowdfunding (Reg CF) which imposes a number of requirements including the filing of financial statements and assurance," says Causholli.

In the study's sample of 1,212 ECF campaigns, 57% of campaigns met their target capital level, over \$150 million was raised in total from 490,427 investors, and 65% of ECFs engaged an independent CPA firm to either review or audit their financial statements. Overall, 10% of the startups were dissolved, went bankrupt, or were inactive in some other form by April 2020.

The researchers then split their sample between the smaller campaigns, where company management have the choice between simply certifying their financials themselves or engaging a CPA firm, and larger campaigns, where management can choose between a CPA review or a full blown audit of their financial statements.

"We wanted to understand whether voluntary assurance was associated with the extent to which startups were successful in raising their target capital. There has been a lot of debate surrounding Reg CF provisions and the SEC is interested in understanding how certain provisions in this regulation impact the development of this market," states Causholli.

The study finds that assurance in the form of a review or an audit by an independent CPA firm improves ECF outcomes. Specifically, startups that engage a CPA firm to review or audit their financial statements are 70 percent more likely to raise at least their target capital, raise about 120 percent more capital, and attract almost 100 additional investors relative to companies that do not engage a CPA firm. In addition, by facilitating capital infusion in the initial stages of the startup's life, the study reports that CPA provided

assurance increases the odds that these companies survive onto the next phase of their lifecycles and are able to obtain subsequent capital in the future.

“We also compared whether audits of financial statements were associated with better ECF outcomes relative to reviews because audits involve additional procedures and provide greater assurance to investors. However, we were not able to find a difference in terms of the amount of capital raised between firms that provided audited financial statements to investors vs. those that provided reviews. We were only able to find that audits attracted more investors. Overall, this seems to suggest that small and inexperienced investors in the ECF market do not differentiate between audits relative to reviews,” reports Causholli.

Causholli concludes, “Entrepreneurs that plan to use ECFs to raise capital are advised to consider hiring an independent CPA firm and obtain assurance about the reliability of their financial statements. However, they don’t have to pay for expensive audits because reviews by an independent auditor are sufficient to attract capital.”



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