



**LUND UNIVERSITY**  
School of Economics and Management

# Removing the statutory audit for small and medium sized companies in Sweden

*- current issues and debates*

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## *Abstract*

- Title:** Removing the statutory audit for small and medium sized companies in Sweden – issues and debates
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- Authors:** Emma Hevlund, Merisa Krijestorac, Hampus Roslin
- Supervisor:** Prof. Anne Loft
- Key words:** SMEs, Statutory audit, Assurance, Related services, Economic crime
- Purpose:** The purpose of this thesis is to contribute to the current debate concerning the removal of the statutory audit for SMEs in Sweden.
- Methodology:** In order to fulfill the thesis purpose a qualitative research approach was used along with triangulation methods. As the basis of the thesis lies in the government report SOU 2008:32 and the official comments to this report, interviews were held with key persons which were considered to be highly affected by the proposal.
- Frame of reference:** The theoretical foundation of this study can be better described as a compilation of necessary information that together form the frame of reference required to understand the issues studied in this thesis. The frame of reference consists of a background and historical review along with information on the current debate, legal reports and official statements.
- Empirical findings:** The empirical data consists of interviews conducted with professionals from Grant Thornton, the Swedish Tax Agency, the Swedish Economic Crime Authority, FAR SRS and the IFAC SMP Committee. Apart from this, information was gathered from other government authorities and accounting journals such as Balans, published by FAR SRS.
- Conclusions:** When contemplating the removal of the statutory audit for SMEs in Sweden, we found that although in matters of principles there is a positive inclination towards the development, there is also a level of uncertainty causing concern. We have found that there is a risk of economic crime rising, as a consequence of the removal of the statutory audit. Furthermore, it has become apparent that the issues concerning the threshold values still remain unclear. The interviewees believe that the need for the assurance given by the statutory audit will remain, as users still will require this information in the future. This means that many SMEs are likely to continue having their accounts audited traditionally. We have also confirmed the common expectation that the auditor's role will develop in the future, requiring the auditor to engage in more consultancy based services. Furthermore, we have discovered that the concepts of reasonable vs. moderate assurance will be difficult to convey in Sweden, not to mention that these may very well be difficult to translate accurately.

## *Sammanfattning*

- Titel:** Revisionspliktens avskaffande för små och medelstora företag i Sverige – den pågående debatten och aktuella frågor
- Seminariedatum:** 12 februari 2010
- Ämne/kurs:** Examensarbete Magisternivå, FEKP01
- Författare:** Emma Hevlund, Merisa Krijestorac, Hampus Roslin
- Handledare:** Prof. Anne Loft
- Nyckelord:** SMEs, Revisionsplikten, Kvalitetsförsäkring, Alternativa metoder, Ekonomisk brottslighet
- Syfte:** Syftet med uppsatsen är att bidra till den pågående debatten om borttagandet av den lagstadgade revisionen för små och medelstora företag i Sverige.
- Metod:** För att kunna genomföra en studie med avsikt att öka förståelse och bidra till den aktuella debatten krävs en övergripande kvalitativ forskningsansats. Vi har valt att tillämpa trianguleringsmetoder för att öka reliabiliteten hos den insamlade informationen. Som grund för uppsatsen ligger bland annat SOU 2008:32, utvalda remissvar samt intervjuer.
- Referensram:** Den teoretiska grunden utgörs av en sammanställning av nödvändig information som berör revision och ytterligare relaterade koncept. Tillsammans med en bakgrundsredogörelse, historisk överblick och inlägg i den pågående debatten bildar denna information den nödvändiga referensramen som behövs för att förstå de förändringar som förväntas träda i kraft senare i år.
- Empiri:** Det empiriska materialet består av intervjuer som genomförts med personer från Grant Thornton, Skatteverket, Ekobrottsmyndigheten, FAR SRS och IFAC SMP Kommittéen. Förutom denna information samlades även ytterligare data in från andra statliga myndigheter och tidskrifter såsom Balans, branschtidningen för revisorer och rådgivare i Sverige.
- Slutsatser:** Vi har kommit fram till att det finns en stor osäkerhet bland våra respondenter vad gäller revisionens framtid. Våra respondenter tror inte att behovet av säkerhet och kvalitet hos den finansiella informationen kommer att ändras och därför förväntas inte heller andelen små och medelstora företagare avstå från den traditionella revisionen, åtminstone inte på kort sikt. Vi har också funnit bekräftelse för den allmänna uppfattning om att revisorns roll kommer att utvecklas till att bli mer inriktad på rådgivande tjänster. Vad gäller den ekonomiska brottsligheten har vi kommit fram till att den kan öka om revisorn försvinner, mycket på grund av revisorn preventiva effekt i detta avseende. Rent tekniskt, har vi även belyst de engelska begreppen ”reasonable” och ”moderate” i termer av kvalitetsförsäkringar. Vi tror att innebörden av dessa begrepp kan bli svåra att förmedla och även svåra att översätta till svenska. Vi anser att kärnan riskerar att gå förlorad vid en felaktig översättning.

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# Table of Contents

1	Introduction.....	8
1.1	Background.....	8
1.2	Problem discussion.....	10
1.3	Purpose.....	12
1.4	Research questions.....	12
1.5	Limitations .....	12
1.6	Thesis plan .....	14
2	Methodology.....	15
2.1	Subject of research.....	15
2.2	Research approach .....	15
2.2.1	Triangulation.....	16
2.3	Interview techniques.....	17
2.3.1	Structured and semi-structured interviewing.....	17
2.3.2	Preparing and conducting the interview .....	18
2.3.3	Choice of respondents.....	18
2.3.3.1	IFAC SMP.....	18
2.3.3.2	Grant Thornton.....	19
2.3.3.3	The Swedish Tax Agency.....	19
2.3.3.4	The Swedish Economic Crime Authority.....	19
2.3.3.5	EAR SRS.....	20
2.4	Criteria in business research.....	20
2.4.1	Reliability.....	20
2.4.2	Replication.....	21
2.4.3	Validity.....	22
3	Frame of reference.....	23
3.1	The audit.....	23
3.1.1	The purpose of the audit.....	23
3.1.2	The role of the auditor.....	24
3.1.2.1	Auditor independence.....	25
3.2	Key audit user groups and expectations on auditing.....	25
3.2.1	Opinion on the fairness of financial statements.....	27
3.2.2	Opinion on the company's ability to continue as a going concern.....	27
3.2.3	Opinion on the company's internal control system.....	27
3.2.4	Opinion on the occurrence of fraud.....	28
3.2.4.1	Opinion on the occurrence of illegal acts.....	28
3.3	Assurance engagements and related services.....	28
3.3.1	The statutory audit.....	29
3.3.2	The engagement letter and review engagement.....	30
3.3.3	The compilation engagement.....	32
3.4	Summary of assurance and engagements.....	33
4	Deregulation in foreign countries .....	34
4.1	A historical review of deregulation in foreign conditions.....	34

4.2	The UK.....	34
4.2.1	Effects of the statutory audit removal in the UK.....	36
4.3	Denmark.....	36
4.3.1.1	<i>Effects of the statutory audit removal in Denmark.....</i>	<i>38</i>
5	Swedish historical review.....	39
5.1	A historical review of auditing in Sweden .....	39
5.1.1	The Swedish Companies Act of 1944.....	39
5.1.2	The Swedish Companies Act of 1975.....	39
5.1.3	The Swedish Companies Act of 1983.....	41
5.1.4	The Swedish Auditors Act of 2001 .....	42
5.1.5	The Swedish Companies Act of 2006.....	42
6	Current debate in Sweden.....	44
6.1	Prominent contributors to the debate.....	44
6.2	Time for a change .....	44
6.3	The audit firms.....	45
6.4	New skills required.....	46
6.5	Cost savings and quality control .....	48
6.6	Economic crime .....	48
7	Swedish legal framework.....	50
7.1	Process leading to a new law .....	50
7.1.1	Executive summary of SOU 2008:32.....	51
7.1.2	Different threshold values .....	53
7.1.3	Consequences .....	55
7.2	Official comments on SOU 2008:32.....	57
7.2.1	FAR SRS.....	57
7.2.2	Swedish Tax Agency.....	58
7.2.3	Swedish Economic Crime Authority.....	59
8	Empirical findings.....	61
8.1	Interview with Dan Brännström, FAR SRS.....	61
8.1.1	From the audit report to the compilation report.....	61
8.1.2	Advantages and disadvantages.....	61
8.1.3	The future of auditing.....	62
8.1.4	The expectation gap.....	63
8.2	Interview with Göran Mårtensson, Swedish Tax Agency.....	63
8.2.1	Detecting fraud and agency resources.....	64
8.2.2	Economic crime and cost issues for SMEs.....	64
8.3	Interview with Stefan Salomonsson, Economic Crime Authority.....	65
8.3.1	Removing an existing control mechanism.....	65
8.3.2	Economic resources.....	66
8.3.3	Assurance and economic crime.....	67
8.3.4	Savings.....	67
8.3.5	Threshold values.....	67
8.4	Interview with Göran Kjellén, IFAC SMP.....	67
8.4.1	IFAC and the removal of the statutory audit.....	68
8.4.2	The future of auditing.....	69

8.4.3	Demand driven auditing.....	70
8.4.4	The future of the auditor.....	71
8.4.5	Expectation gap.....	71
8.4.6	Economic crime.....	71
8.4.7	Comparisons with foreign countries.....	72
8.5	Interview with Christofer Hultén, Grant Thornton.....	73
8.5.1	Current duties and the auditing profession.....	73
8.5.2	SMEs and potential benefits of the reform.....	74
8.5.3	Alternative methods.....	74
8.5.4	Economic crime.....	75
8.5.5	The recession and audit .....	75
9	Analysis and discussion.....	76
9.1	The audit profession in general.....	76
9.1.1	Negative effect on the audit profession.....	77
9.1.2	The auditors and service fees.....	78
9.1.3	The financial crisis and demand for audits.....	79
9.2	Quality and assurance .....	82
9.2.1	Assurance, quality and the expectation gap.....	83
9.3	Economic crime.....	84
10	Conclusions.....	87
10.1	On the profession in general.....	87
10.2	On alternative methods and assurance .....	88
10.3	On economic crime .....	89
11	Reflections.....	90
11.1	Methodological considerations.....	90
11.2	Theoretical considerations.....	91
11.3	Suggestions for further research.....	91
12	References.....	97

## Figures

Fig 1. Triangulation model (constructed by authors)

Fig 2. Revised model on Assurance Engagements and Related Services (based on Hayes et al)

Fig 3. The Statutory Audit

Fig 4. Model of assurances and engagements (constructed by authors)

Fig 5 Swedish law-making process model by Ministry of Justice.

# 1 Introduction

*This first chapter starts with a background and problem discussion narrowing down our subject of interest to a few thesis questions. Also the main purpose of the thesis is presented along with the delimitations of the study. The chapter is concluded with a thesis disposition.*

## 1.1 Background

In Sweden there are currently about 330 000 companies that are obliged to have a statutory audit, this in accordance with the Fourth Company Law Directive (78/660/EEC) that all companies covered by the Directive must have their annual accounts audited by a qualified professional (2010a). Member States may however in accordance to article 51 of the Directive exempt small companies from this obligation in certain cases. In accordance with the Directive, Member States may grant statutory audit exemptions to small firms if these do not exceed two of the three threshold values proposed by the Commission. The definition of a “small” company given in the Directive is given by the threshold values:

- balance sheet total: 3,65 MEUR (37,58 MSEK)<sup>1</sup>
- net turnover: 7,3 MEUR (75,16 MSEK)
- average number of employees during the financial year: 50 employees

In the same Directive the Commission defines a company as “medium-sized” if it does not exceed two of the three following criteria.

- balance sheet total: 14,6 MEUR (150,31 MSEK)
- net turnover: 29,2 MEUR (300,63 MSEK)
- average number of employees during the financial year: 250 employees

As of today there are two member countries in the European Union which have not taken advantage of this opportunity, these are Sweden and Malta. When contemplating the removal of the statutory audit, which means altering a law, Swedish law (2007:1244) requires an extensive consequence analysis to be done before altering laws. In 2006 the Swedish Government therefore started an investigation concerning the national removal of the statutory audit for small and medium-sized companies.

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<sup>1</sup> To enhance the comparability between the Swedish currency (SEK) and the official values stated in the Fourth Company Law Directive, the official total has been converted to SEK using the 01-01-2010 exchange rate. The conversion is stated in brackets and will continue to be done so throughout this thesis.



This resulted in the Swedish Government Official Report SOU 2008:32 “*Avskaffande av revisionsplikten för små företag*” (2010b). The key issues in the report concern the auditor's mandate period, obligation to report irregularities, the review of the company's management and of course the fact that the statutory audit should be removed for SMEs. The proposed changes are expected to come into force on 1 July 2010. Given the current conditions the proposal will affect 96 percent of all limited companies in Sweden, meaning that only 4 percent of limited companies in Sweden will be obliged to the statutory audit. . The Governments decision on this, expected to be announced in the beginning of 2010 has been postponed until May (2010c). One of the reasons for this is that the Ministry of Finance is unsure about which threshold values to set. The goal however is still to remove the statutory audit in July. The thresholds proposed in the SOU 2008:32 report are the following:

- balance sheet total: 83 MSEK
- net turnover: 41,5 MSEK
- average number of employees during the financial year: 50 employees

This means that if two of the thresholds are met then the company is obliged to be audited.

As the Directive also states that all EU Member States may chose which national threshold values to adopt as long as these do not exceed those proposed by the Commission. How the threshold values differ between countries depends therefore on national governance and politics. In the “*Report on impacts of raised thresholds defining SMEs*” by Ramboll Management in Stockholm from 2005 it is concluded that the willingness of Member States to implement higher thresholds defining SMEs seems to be related to their motivation to alleviate their companies from regulatory burdens. Furthermore the report concludes that if the EU level of thresholds is raised then the current differences between national thresholds will grow, making it difficult to find common grounds for benchmarking. An interesting conclusion in the report is that Member States with the largest amount of bankruptcies per 10 000 companies are the same countries that have chosen to fully implement the relief option (2010d). This in turn relates to the issue of eventual transparency and insight loss with the removal of the statutory audit and the auditor.

Proponents for the removal of the statutory audit often emphasize economic factors maintaining that statutory audits are time-consuming and costly. One main argument used by those in favor of the reform and also often featured in the current debate is that companies have been estimated to minimize their total costs. The government expects the total estimate to be 5,8 billion SEK if the statutory audit obligation is removed (SOU 2008:32). This argument is often raised in the media coverage on the current debate, for example in Balans (2008:4, p17). Balans is the professional business magazine in the

field of accounting and auditing published by FAR SRS, the institute for the accountancy profession in Sweden and is together with FAR SRS an important actor in the standard setting process in this field.

Opponents on the other hand suggest that economic crime may rise and that the economic gains from the removal will instead have to be spent on monitoring control mechanisms and the development of control systems. The Swedish Tax Agency for instance may well end up having to improve and increase their control systems once the auditors work is discontinued. This concern was voiced already during the 1990s by the government in the government letter 1994/95:217 where the government warns that removing the auditor may increase economic crime in society (2010e). This view is still present and shared by both the Swedish Tax Agency and the Swedish Economic Crime Authority. Both authorities have in their comments to SOU 2008:32 raised awareness and shown certain reluctance to abolish the statutory audit.

## **1.2 Problem discussion**

In attempts to harmonize the financial information published by companies, thus increasing confidence in the market the role of the statutory audit has come to be the subject of discussion worldwide. In the process of creating a harmonized international auditing profession and community, national professionals and governments are working under the influence of international regulatory bodies such as IFAC to find national convergence in various auditing matters. One such matter is for instance the convergence of auditing standards for professionals and finding harmonization between national and international standard-setters with regards to political systems, culture, professionalism and economic hurdles.

An important issue here is whether competition should be introduced into the Swedish auditing system and accounting profession. Removing the statutory audit entails giving SMEs the right to chose between various levels of assurance and will, in doing so, result in a more competitive market which otherwise is regarded as the cornerstone of functioning financial service markets in the European Union (2010f). The market will become more competitive in the sense that audit related services will be able to be performed by others than certified auditors. Perhaps fees for related services will differ more once the market of these services become more demand-driven.

The Swedish government and the EU have for the last couple of years taken initiatives allowing businesses to be run more cost-efficiently as well as simplifying administrative tasks and regulations in order to reduce unnecessary economic burdens and pressures on small businesses. Removing the

statutory audit is part of this process and will have consequences for all the current audit users. Traditionally the role of the audit has been to ensure a certain quality of the financial information provided by the company to the market. If this assurance and quality can be attained through alternative methods is a key issue in the current debate regarding the statutory audit.

An issue addressed by the Association of Chartered Certified Accountants (ACCA<sup>2</sup>) is that of the occurrence of economic crime as the amount of regulations decreases, small companies become an increasingly attractive vehicle for this sort of crime. ACCA also addresses the fact the impact fraud or economic crime may have on other parties with which the fraudulent company does business (2010g).

When addressing the occurrence of economic fraud and crime the role of the auditor in detecting and/or preventing fraud must be discussed. This leads to a debate regarding the auditors fundamental role in practice, and also the many perceptions and expectations on the auditor, more commonly known as the expectation gap. The auditor, apart from lending credibility to published financial statements, is expected to design the audit in such a way that there is a reasonable chance of detecting material fraud. The audit, if performed well, has the ability to deter and/or detect fraud as well as other misstatements (correspondence, Paul Thompson, Senior Technical Manager IFAC). Also when weighing the benefits of detecting fraud it is important to consider the costs of doing so. One could go to great lengths to eliminate fraud but then again the cost of doing so may easily outweigh the benefits the reduced fraud. The key issue here is finding the balance between the overall costs and benefits.

If the statutory audit is to be removed, alternative methods of giving assurance must be examined in a Swedish context. If Sweden follows in the footsteps of the other Member States the most common form of report on financial statements will be the compilation report<sup>3</sup>. This reform will therefore surely effect the daily work and current services provided by the auditor. The auditor may well take on the role of a financial advisor to some extent, depending on what the client demands.

The issues discussed in this problem discussion are those underlying this study. As shown here there are many different perspectives through which the current situation can be examined. The goal here is to shed light on the many issues concerning the removal of the statutory audit for SMEs in Sweden, thus contributing to the current debate.

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<sup>2</sup> ACCA is the global body for professional accountants supporting over 130 000 members and 360 000 student through a network of offices and activity centers. Through expertise and experience ACCA aims to with governments and professional bodies such as IFAC to develop the global accountancy profession.

<sup>3</sup> A compilation report is limited to presenting information that is the representation of management in the form of financial statement and supplementary information. The compilation report does not express any opinion or any other form of assurance on these statements.

### **1.3 Purpose**

The main objective of this thesis is to contribute to the ongoing debate concerning the removal of the statutory audit for small companies in Sweden as proposed in SOU 2008:32. In doing so the issues addressed will be how the removal of the statutory audit may effect the occurrence of economic fraud and crime, the future quality and assurance of financial statements, as well as the effects on the auditors future work.

### **1.4 Research questions**

The issues raised in the problem discussion along with the above purpose statement provide an understanding to the fundamental questions aimed to be discussed in the following chapters.

In order to fulfill our research purpose we have gathered information from professionals from the Swedish Economic Crime Authority, the Swedish Tax Agency, the IFAC SMP Committee, FAR SRS and one of Sweden's largest audit firms whose primary clients are smaller and medium sized practices, namely Grant Thornton. The key issues addressed in this study have been rephrased and summarized in the following questions:

- What can be expected of the effects on the removal of the statutory audit for SMEs regarding the audit profession in general?
- What can be said about alternative methods of obtaining assurance?
- What can be said about the risk and occurrence of economic crime in reference to the removal of the statutory audit of small companies?

### **1.5 Limitations**

Firstly, in order to reach the proposed deadline it was decided that the information gathered would be completed with interviews with IFAC, Grant Thornton, FAR SRS, the Swedish Tax Agency and the Swedish Economic Crime Prevention Authority. We concluded that in order to fulfill our purpose we had to use a triangulation method approach, addressing all interviewees with a few main topics. Ideally we would have liked to interview a greater number of professionals from other firms and departments as well, but given the time limitation this alternative was ruled out.

Secondly, as the purpose was to contribute to the current debate of the statutory audit another approach could have been to shift focus to the actual companies. However when contemplating this approach it was concluded that we would be less successful in gaining information on the potential risk

of economic crime from the companies themselves. Furthermore the companies would not be the most appropriate respondents when addressing issues related to quality and assurance of financial information in light of the removal of the auditor. For these reasons this perspective has been excluded in this study. Yet another approach in addressing the current debate could have been to shift focus to credit institutes and banks. This approach however would be too narrow considering the purpose of the thesis. Also we found that research on this subject had already been done on many academic levels.

Yet another limitation is that concerning the decision to focus strictly on Sweden and not conduct a comparative study. This approach was initially of interest as most European countries have already removed the statutory audit. Therefore, it would have been interesting to compare the Swedish development with other countries in Europe. Due to lack of data and the time limitation it was deemed impossible to pursue such an approach. Still, we found it could be interesting to shed light upon the Danish and UK development in this area. Denmark was chosen, as it is a close neighboring country to Sweden. For this reason the medial coverage has many times chosen to point to the Danish development when discussing the potential effects in a Swedish context. We also chose to present the UK as the UK was the first country to remove the statutory audit for SMEs. For both these countries we discuss issues that could be relevant in understanding the Swedish development. In conclusion, this information will not be used in a comparative purpose but rather for an overall understanding of the consequences for the removal of the statutory audit for SMEs.

## 1.6 Thesis plan

**Introduction** The first chapter aims at presenting the reader with an interesting problem discussion and the main purpose of this thesis. In doing so the underlining research questions will be presented along with the thesis limitations.

**Methodology** The methodology chapter addresses the main research method and methodology contemplations which the thesis is based on. Furthermore the overall credibility of thesis is discussed along with description of the data collection process.

**Frame of reference** The frame of reference chapter aims at presenting the fundamentals of auditing in order to clarify the basics underlining this thesis. This will enable the reader to better understand the analysis and conclusions in the chapters to come.

**Deregulation in foreign countries** Here the reader is presented with a review of the deregulation process in foreign countries. Denmark and the UK are the companies which prove to be interesting through a Swedish perspective.

**Swedish historical review** This chapter presents the Swedish historical background concerning audit regulation.

**Current debate** In this chapter the reader is brought up to date on the current debate in Sweden.

**Swedish legal framework** In this chapter a summary of the legal framework SOU 2008:32 will be presented along with official comments in reference to the SOU 2008:32 report from certain parties of interest. Also this chapter presents the law-making process in Sweden, showing the reader where in the process the SOU 2008:32 can be placed.

**Empirical findings** Here, the empirical findings are presented. Our interviewees comment on alternative methods, assurance, the future of auditing, the expectation gap and economic crime.

**Analysis and discussion** The analysis brings all previous information together. The aim of the analysis is to approach the problem discussion connecting the empirical findings to the given frame of reference, ultimately resulting in a further and deeper discussion.

**Conclusions** In this chapter the research questions posed in the introductory chapter are answered.

**Reflections** In this concluding chapter we discuss methodological and theoretical contemplations. We have also chosen to give suggestions on further research which we think may be relevant in the future.

## 2 Methodology

*This chapter covers a number of important issues relating to the research methods and the analytical procedures used within our thesis. Data source collection and the approach used to analyze this data will also be discussed. Finally three of the most prominent criteria used for the evaluation of business research will be treated.*

### 2.1 Subject of research

The subject addressed in this thesis is one that has been studied on various academic levels in a range of different perspectives. In 2001, Bresser and Nilsson examined the auditor's obligations towards reporting irregularities in their revisions. In 2006, Skenberg and Kreivi wrote about the statutory audit and banks also Karlsson, Kraft and Listerud examined the connection between the occurrence of economic crime and the statutory audit. In 2008 Otang and Gabsia studies the demand for auditing in small firms. In the same year Borg and Sopa wrote about the removal of the statutory audit from an SME perspective. These are only a few of the academic studies found. It can be argued that sufficient work on this subject has therefore been done.

However we feel that this merely shows that there is a growing interest on the subject concerning the removal of the statutory audit for SMEs. Also, conditions change and so do attitudes which makes us believe that yet another thesis on this matter can only support the current debate. Our purpose is to contribute to the ongoing debate in Sweden by the information obtained in the interviews performed with professionals in the field of auditing as well as those working for government authorities. We are interested in gaining understanding of their perspectives and will in the research analysis do this through a business research perspective.

### 2.2 Research approach

In order to fulfill our purpose we must gain understanding of the current situation as well as the background leading to this point. We seek to gain knowledge of how our respondents perceive the current situation and what they believe can be said about issues relating to this such as that of the future of the auditing profession and the occurrence of economic crime in the future as a result of the removal of the statutory audit for SMEs. In a methodological perspective our purpose is best described as qualitative and interpretative. What characterizes qualitative research is the focus on words rather than numbers as in the case of quantitative research (Bryman and Bell 2003: 280).

In accordance with what is typically associated with the qualitative research approach, we aim to focus

on our interviewees' perceptions and interpretations of the current situation. We aim to gain information for further interpretation through both structured and semi structured interviews, in person and through electronic correspondence.

### 2.2.1 Triangulation

The concept of triangulation entails using more than one method or source of data in research thus enhancing the confidence of the findings (Bryman 2007 p.412). In our case we have applied triangulation by gathering and cross verifying information through various interviewee's. The objective of triangulation is to enhance the research credibility by applying various methods for gatherings and processing information.

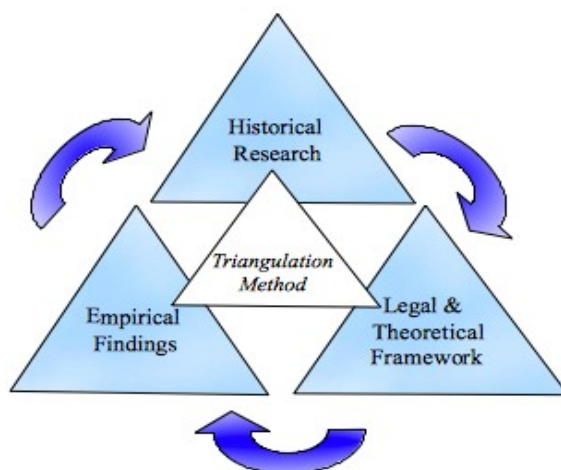


Fig1. Triangulation model (constructed by authors)

In our case we found that the triangulation method could be useful as we were interested in gaining information through various perspectives. This meant perceiving the subject of research from the perspectives of the interviewees. Also by first gaining the understanding of the legal procedures and historical background driving the current situation we were then able to cross-check any information with our interviewee's that remained unclear resulting in a more detailed and balanced understanding of our research subject.



## **2.3 Interview techniques**

An underlying premisses of our research was that we would be able to conduct interviews from professionals with a greater understanding of the current situation regarding the statutory audit. As our purpose was to contribute to the ongoing debate we deemed it necessary to gain insight on the different views working professionals might have on the subject. This meant understanding the subject from different perspectives and thus resulting in the selection of interviewee's from the Economic Crime Authority, Tax Agency, IFAC SMP Committee, FAR SRS and also an audit firm, in our case Grant Thornton.

This section covers the main interview techniques used in the information gathering process. The two main types of interview methods in qualitative research consist of the unstructured and the structured interview (Bryman and Bell 2003). Theoretically these types are presented as extremes with a range of variability between them. In reality the most interviews are closer to one of the extreme types than the other. When determining which method to chose the desired outcome and actual purpose of the interview must be considered. In the qualitative interview there is a great interest in the interviewee's perception and opinions, this should be reflected in the way questions are formulated and also in the choice of interview method. In this study we have chosen to conduct structured interviews with open questions giving the interviewee the possibility to give more in-depth answers as some of the interviews were done via email. When possible, interviews were conducted in person resulting in semi-structured interviews. In both cases, an interview guide was used and questions were formulated under the different topics addressed in the interviews.

### **2.3.1 Structured and semi-structured interviewing**

The main reason for conducting structured interviews with questions prepared beforehand was to minimize the differences between the interviews conducted (Bryman and Bell 2003). By preparing the questions beforehand we were able to formulate the best possible questions thus minimizing any risk of confusion on the interviewee's behalf. The same questions were posed regardless of whether the interviews were conducted in emails or in person. The difference was rather that if the opportunity was given to conduct an interview in person then we could better respond to the interviewee's answers and deviate somewhat from the interview questions, resulting in a semi-structured interview. The opportunity of conducting semi-structured interviews was rather regarded as a bonus on our behalf. The main source of gaining information from our interviewees was through email correspondence and by them answering our interview questions in written form. Three out of the five interviews were conducted in person.

### **2.3.2 Preparing and conducting the interview**

The purpose of the interview guide is to provide guidance throughout the interview. When preparing our interview guide we firstly asked ourselves whom the subject of the interview was. Once this was determined we continued by contemplating what in fact we were interested in finding out. From there we decided on various topics that were of interest depending on the interviewee's special competence. When preparing questions for the respondents consideration had to be taken to the position of the respondent. Before conducting the interviews each interviewee was sent a copy of our thesis purpose and also a draft of the topics and questions that were to be included in the actual interview. We felt it important that the interviewee understand our goals. By sending over questions beforehand the interviewee was able to prepare for the interview, also this showed the tone of the interview which we felt would minimize reluctance to participate in our study. In preparing for the thesis some interviewees were contacted as early as two months in advance as we anticipated that the end of year period is a hectic one and we were more likely receive positive feedback earlier on in the year.

In the cases where the interviews were conducted online, we still tried to maintain the same depth in our questions. Being aware of the fact that follow-up questions are impossible in the online personal interview we aimed at sending very clear questions, encouraging the interviewee to give more elaborate answers. In the events that we still lacked information on a given subject, the interviewee was contacted at a later stage for further clarification.

### **2.3.3 Choice of respondents**

In order to attain different perspectives on the research subject, various agencies and companies were contacted. A closer description of respondents from each source will in the following sections be given.

#### **2.3.3.1 IFAC SMP**

We chose to contact IFAC as this organization represents the accountancy profession on a global level. As IFAC's mission is to serve the public interest IFAC is very much involved in developing and promoting international convergence within the accountancy profession worldwide (*IFAC Strategic Plan 2009-2012*). For our thesis we first contacted the SMP Committee through Paul Thompson, Senior Technical Manager at IFAC. Through correspondence with Paul Thompson we were later introduced to Göran Kjellén, technical adviser in the IFAC SMP Committee. Through correspondence and then an in depth online interview with Göran Kjellén information regarding the removal of the statutory audit was gained from the IFAC SMP perspective.

### **2.3.3.2 Grant Thornton**

Grant Thornton is one of the leading assurance and consulting firms in Sweden that provides assistance in the field of assurance, audit, tax and accounting services. In light of our thesis purpose we chose Grant Thornton as its focus and clients are owner-led companies, basically the SMPs most affected by the removal of the statutory audit (2010h).

At the office in Malmö an interview was conducted with partner and CPA, Christofer Hultén. Prior to the interview the structure and purpose of the interview was sent to the interviewee. As the interview was done in person the interview was recorded and later transcribed. This interview gave an auditor perspective to the study and also insight on how Grant Thornton, whose primary client will be affected by the removal of the statutory audit, have prepared for the change.

### **2.3.3.3 The Swedish Tax Agency**

By interviewing the Swedish Tax Agency we gained understanding on the current debate through yet another perspective. The Tax Agency plays an important role in detecting economic crime through random sample tests on income and tax declarations and could very well be expected to be affected by the new legislation. As the Tax Agency works proactively and preventively, it is essential that it in the future can continue to provide the same level of service to the community (2010i)

For further insight on the Agency's work we contacted Göran Mårtensson at the office in Malmö. The interview with Mårtensson was done in person and also recorded.

### **2.3.3.4 The Swedish Economic Crime Authority**

In order to gain depth on the economic crime perspective in this study an interview was conducted with Stefan Salomonsson, economist at the Swedish Economic Crime Authority. The main goal of this authority is to bring about security and justice by preventing and combating economic crime. The Authority has a national responsibility for preventing economic crime and works together with other actors in doing so. As economic crime is multifaceted it can be detected in different ways which is another reason for the Authority to work with other actors (2010j). One example of this collaboration is with the Swedish Tax Agency which primarily focuses on tax crime. In cases of tax crimes and false accounting specialist from both authorities work collaborate in the investigations (ibid). This interview was also recorded and later transcribed.

### **2.3.3.5 FAR SRS**

For insight on the general development concerning the statutory audit we chose to interview FAR SRS. This is the professional institute for authorized public accountants, approved public accountants and other highly qualified professionals in the accountancy sector in Sweden (2010k). As FAR SRS plays an important role in the development of professional standards, education and information for the audit profession in Sweden we believed that the insight gained from this respondent would contribute to the overall goal of this thesis. When contacting FAR SRS we managed to get a hold of Dan Brännström, the secretary-general of FAR SRS which basically means that he is in charge of the organizations operative work. Brännström received the questions and purpose of the thesis for a greater understanding of our goals and hopes for the thesis. As Brännström works in Stockholm the only means of getting an interview with him was through an email.

## **2.4 Criteria in business research**

According to Bryman and Bell (2003:33) the most prominent criteria for the evaluation of business and management research are reliability, replication and validity. The idea of reliability refers to the concept of duplication, meaning that a study is said to be reliable if an external party may obtain the same research results if the study were to be performed a second time.

This idea is very closely related to the concept of replication. The point being that in order to assess the concept of reliability, the procedures leading to the research outcome must be replicable and therefore presented in great detail. The most important criteria however may well be obtaining validity in the conclusions generated by the research. In essence this term refers to the integrity of the study, to what extent the study actually addresses the key issues as intended.

### **2.4.1 Reliability**

The term reliability in qualitative research can be understood through an internal and external perspective. The degree of internal reliability in qualitative research deals with the members of the research team. Bryman and Bell (2003:288) conclude that internal reliability reflects the degree to which members of a research team agree about what they see and hear. This notion, when applied to the techniques of interviewing in this thesis sets a demand on the persons handling the interviews. This means raising awareness and understanding of factors influencing the both the interviewer and interviewee in order to establish credibility of the research findings (ibid).

In order raise credibility to the findings of this thesis the personal interviewees were recorded and later

transcribed. All group members together then discussed the findings ultimately resulting in an analysis. This effort raised the internal reliability in one sense, however to raise the credibility from the interviewee's perspective other measures were taken. The interviewee for instance was in addition to seeing the interview questions beforehand also received information on the purpose and underlying thesis questions dealt with in the thesis. We believe this allowed the interviewee to better prepare for the interview allowing him to think about the information provided during the interview. The online interviews were easier to perform in this respect as the interviewee could take as much time needed in order to answer the questions before submitting his answers. Another issue dealing with the reliability of this thesis has to do with the translation of the interviewees from Swedish to English. To minimize the errors in this process much time was dedicated to translating the information gathered from the various interviewees.

The issue of external reliability, the degree of replicability, in qualitative research is a difficult criterion to meet according to Bryman and Bell (2003: 288). As the purpose of this thesis is to understand a current social setting along with its circumstances and future development an exact replication of this study at another time could land different results, thus entailing a somewhat lower level of external reliability. This does however not mean an overall weakened level of credibility but rather shows that qualitative research based on interviews are contingent rather than based on fixed assumptions or information as is the case in quantitative research.

#### **2.4.2 Replication**

As explained before the criteria of replication is closely linked to the concept of external reliability, and considered to be essential in research as it allows others to complete or develop the research findings ultimately leading research further. In the quantitative methodology this is especially important as it allows researchers to cross-examine the quantitative evidence. In the qualitative methodology on the other hand replication for this reason is less likely as the purpose of qualitative research is more likely to focus on the understandings of social phenomena and perceptions which cannot be cross-examined to the same extent (Bryman and Bell 2003).

Replication in qualitative research, as is the case in this study can instead be understood in another sense, in terms of methodology meaning that the processes leading to the thesis results are explained. For this reason greater detail has been put into discussing the choices made in the methodology section.

### **2.4.3 Validity**

The third concept addressed by Bryman and Bell relevant for qualitative research relates to congruency between the researcher's observations and theoretical ideas generated by the study, internal validity, and the degree of generalization of the research findings, external validity (2003:286).

To ensure a high level of internal validity the empirical evidence was carefully examined in order to ensure a high level transparency, strengthening the findings of this thesis. The difficulties in generalizing the findings of this study, as suggested by LeCompte and Goetz in Bryman and Bell are common for many qualitative studies and especially those employing case studies and small samples (2003:288).

## 3 Frame of reference

*This chapter aims at increasing the readers knowledge of the fundamentals issues underlying this thesis. Firstly, the audit is presented, giving the reader a deeper and more theoretical understanding of the purpose of the audit as well as the actual auditor.*

### 3.1 The audit

The following sections describe the purpose of the audit and auditor. In doing so the various users of the audit will be presented as well as other central issues concerning the auditor.

#### 3.1.1 The purpose of the audit

The first International Auditing Practices Committee (IAPC) of IFAC stated in 1980 that the objective of the audit of financial statements prepared within a framework of recognized accounting policies to enable an auditor to express an opinion on the statements in order to establish credibility (D. Flint 1988). Another definition given by the American Institute of Certified Public Accountants (AICPA) states that the objective of an examination by the independent auditor through generally accepted accounting principles is the expression of an opinion on the fairness on the financial statements. So the purpose of all audit is to ensure proper financial reporting, which means ensuring transparency, assessing liability and in doing so maintaining credibility. With regard to the many users of the financial information, the auditors work reflects the societies needs for trustworthy information. It is therefore the auditor's obligation to obtain sufficient and appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion (Hayes et al. p.353) Here, sufficiency, refers to the measure of quantity of audit evidence and appropriateness referring to the measure of quality including relevance and reliability in the classes of transactions, account balances and disclosures.

However to be able to discuss the purpose of the audit in a real context the audit must be put into relation to its users. Theories explaining the demand of audit services include the the Policeman Theory and the Lending Credibility Theory (Hayes et al. p45). Both of these theories focus on the public perceptions of the audit and the auditors obligations. The Policeman Theory for example flourishes and gains public hearing especially when financial frauds are exposed and the public debate turns to the auditor's responsibility for detection and disclosure of fraud. In other contexts these demands relate to the need of corporate auditing, management auditing and operational auditing (Flint 1988). These types of audits deal with the investigation of improper conduct in accounting. In these cases the audit is needed to verify the information given in the annual accounts.

The theoretical concept of the audit cannot be explained with one single definition as it has been the subject of research through different perspectives. One perspective that reflects the public demand for the audit is that of the social audit where the social function of the audit is emphasized. In this context the social audit is not limited to the stockholders but to the public and many users of the financial information. Auditing in this sense is an important tool in managing the public's anxiety and expectations.

A simpler definition given by FAR SRS (2010) states that the primary objective of the audit is to assure the quality of the financial in Sweden states that the primary objective of the audit is to assure the quality of the financial information provided by the client company to the market.

### **3.1.2 The role of the auditor**

With an understanding of the actual audit it seems only natural to discuss the requirements posed on the person performing the audit. Pentland (1993:606) defines auditors as those who *“judge and attest to the validity of corporate financial statements, which contain a stylized interpretation of the fiscal health of a corporation”*. An auditor therefore needs to have experience in accounting and economic conditions that is required regarding the scope of the company's activities, in order to be able to fulfill the assignment. The main tasks of an auditor in a Swedish auditing assignment is to review and in an audit report give a report regarding if the company has fulfilled the obligations for the tax payment law and to take certain action if there is a suspicion of crime. He has an obligation regarding information and reporting. According to SOU 2008:32 the audit report contains information such as:

- What standards for accounting the company applies
- What standards for auditing the auditor applies
- If the auditors scope is limited
- If the annual report has been established in accordance to the applicable law of annual report
- If the auditor in a matter that is treated in the audit report has a different opinion than the company management
- If the auditor considers that he is missing adequate basis in order to comment if the annual report has been established in accordance with applicable law of annual report
- If someone in the company management has taken measures or has been neglectful in a way that can result in liability to pay compensation
- If the auditor considers that he is missing adequate basis in order to comment if anyone in the company management has taken measures or has been neglect able in a way that can result in a liability to pay compensation
- If the company has not fulfilled certain obligations according to the tax legislation



This seems fairly simple and understandable, the auditor is a qualified, independent and professional person who gives opinions on the review of financial statement. However the meaning of what professionalism and auditor independence entails is more complicated and differs in an international perspective as concluded by Vanasco, Skousen and Santagato (1997). It is for this reason governments of several countries have implemented professional audit standards sanctioned by professional accounting associations such as IFAC, when dealing with issues of auditor independence.

### **3.1.2.1 Auditor independence**

In 2009 the International Ethics Standards Board for Accountants (IESBA) released the revised Code of Ethics for Professional Accountants most commonly referred to as the Code. The Code contains details on the ethical requirements for professional accountants which are to be complied with by all IFAC member bodies to the extent possible. The Code is divided into three parts which deal with the identification of threats to the fundamental principles, the evaluation of the threats and the application of safeguards in eliminating or reducing the identified threats (The Code sec 100 §2).

The fundamental principles a professional accountant must comply with are those related to integrity, objectivity, professional competence and due care as well as confidentiality and professional behavior. One key concept discussed frequently in the Code is that of auditor independence. In section 290 paragraph 6 the independence concept is defined as:

*Independence of Mind: The state of mind that permits the expression of a conclusion without being affected by influences that comprise professional judgement, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.*

*Independence in Appearance: The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional skepticism has been compromised.*

## **3.2 Key audit user groups and expectations on auditing**

Key user groups of the audit are defined as the stakeholders. Gray (2001: 11) refers to stakeholders as basically anyone who has an influence or is influenced by the organization. The users of the audit services provided by the audit firm are often referred to as the auditees. This generally includes all

stakeholder parties. These being the board of directors of the audited company and all third party stakeholders such as shareholders, bankers, creditors, customers and employees.

These auditees and third parties may directly and indirectly rely on auditing to provide assurance about the financial information being audited. The reason for defining stakeholders becomes interesting when put into context. In the auditing profession where the final product provided is the audit itself, the concept of accountability and assurance are central for the stakeholders. When applying the stakeholder model Gray (2001:12) suggest breaking down the broad group of stakeholders into constituent parts, resulting in an array of stakeholders. Doing this provides further information on the relationships and information flows between the various groups. Here, we have decided to focus on the broader groups as we deem this description to be sufficient.

The stakeholders of a company are those individuals or companies who, by various means, have a stake in an organization. A shareholder, for example, maintains a stake in the organization by the possession of shares. This model is commonly divided in two different views of the stakeholders. On one hand there is the “claimant” view of the stakeholder, which means that a person or group with a stake in the organization makes a claim of what's rightfully theirs. But they can't directly influence the organization in which they have a stake in. On the other hand there are stakeholders who can influence the organization to some degree and thus this view has emerged as the “influencer”.

Each group of users apart from having their own needs, also differentiate themselves by their own set of expectations with regard to the auditor's duties. Some developments and changes have occurred within the auditing profession during the past 50 years. The auditor was often seen as a professional who's main purpose was to prevent and detect fraud within the auditees. Nowadays this view of the auditor has shifted more towards verification of truth and fairness of financial statements. This development, however, have not been able to be explained and it's still an open debate why the auditors duties and expectations have changed. This controversy has been known as the audit expectations gap debate. This gap is manifested when users of the audit services have expectations on the audit services performed. These expectations often exceed the actual services carried out by the auditor in accordance to the current practice in the profession (Hayes et al. 2005: p57). Studies have shown that the key expectations can be summarized as giving assurance and opinions on (Hayes et al. p58-64):

- the fairness of financial statements
- the company's ability to continue as going concern
- the company's internal control system
- the occurrence of fraud and illegal acts

### **3.2.1 Opinion on the fairness of financial statements**

The core business of the auditor has normally been to appreciate and give a qualified opinion on the fairness of the financial statements. National and international guidelines are therefore mostly concerned with this part of the auditing profession. Several studies have for that reason been made to reveal the expectation gaps in this area. It was found that expectations among the general public was high. This means that a large portion of the financial community believes or expects that an unqualified audit opinion drafted by an auditor is completely free from errors. Since this is not true, and can not be expected by an auditor, a gap has occurred. The inherent limitations within the profession are perhaps not accepted or fully understood by the general public, i.e the group of users (ibid).

### **3.2.2 Opinion on the company's ability to continue as a going concern**

The public has on numerous occasions lost their trust in the audit profession. Every time an unqualified audit report has been issued and shortly after followed by bankruptcy it has undermined the general public's reliance in the profession. According to ISA and other national guidelines an auditor has to establish whether the auditee can continue as a going concern. If it's found that there are serious doubt about the company's ability to continue as a going concern this should be expressed both in the financial statements and in the auditors opinion. The auditor should however tread lightly in the regard of expressing an opinion which states that a company may have problem with continuing as a going concern. Such a claim may turn out be a self fulfilling prophecy which may ensure a quick downward spiral which ultimately leads to bankruptcy. If the auditor finds that there still is a chance of recovering the company it's ultimately up to the auditor to make a difficult judgment call often based on several factors.

### **3.2.3 Opinion on the company's internal control system**

There has been much focus on the auditors responsibility's when it comes to testing an reporting on the quality of the audited entity's internal control system. In the ISA 400 it states that the auditor is required to obtain and gather information about the internal control systems so that the he or she is able to get an understanding about it. When an understanding is established it's, according to ISA, probable that the auditor can form a sufficient plan and approach for the audit. The adequacy of the internal control systems are however not required to be tested by the auditor. The audit objective can instead be met by using substantive testing, if it is reported by the auditor that this approach is more sufficient. This ultimately means that the internal control structures are not examined, only fragmentary tested. It was however more important to get an assurance on the company's internal control systems in the 1980's. It had become a predominant part of the management letters. This issue was later gradually reduced. Maybe, as a result of this, it has been shown in surveys that the expectations on the auditor's

significance when it comes to the evaluation of the company's internal control systems are far to great, and exceeds the auditors obligations.

### **3.2.4 Opinion on the occurrence of fraud**

The auditor's ability to determine whether fraud has been committed has for a long time been a focal issue for both government and financial communities. Expectations has always been high, and this can probably be derived from the evolution of auditing. If we go back to the first decades of auditing, the detection of fraud was one of the biggest concerns of both auditors and auditees. This have however changed in the same rate as company's structural complexities have increased. The occurrence of fraud is more difficult to detect for the auditors, hence it would also be to expensive for companies to engage an audit firm for this explicit purpose. Although, in recent years a number of fraud scandals have chocked the world, such as Enron, Worldcom etc, the list is long. This has renewed the discussion on who should be responsible for any fraudulent financial statements which might lead to a collapse of a company in the future. The expectations on auditors have always been high, and clearly exceeds the auditors ability and current duties.

#### **3.2.4.1 Opinion on the occurrence of illegal acts**

The occurrence of illegal acts is closely related to the subject of occurrence of fraud. Most national regulators and the ISA states that the audit should be conducted in a manner which allows the auditor to collect information which will get the auditor reasonable expectations to detect any kind of material illegal that have a direct impact on the financial statements. The auditor also has to consider, when reporting illegal acts, how significant the impact will be on the financial statements. Some countries have also ruled that the auditor, apart from disclosing the illegal acts through the report, also have to inform the board of directors or members of the audit committee. It is not allowed, however, to inform third parties such as shareholders or investors about the findings of the auditor. Surveys have found that expectations on the auditor's ability to detect and report illegal acts are vague and inconclusive. Further studies might therefore be needed to get sufficient data on the matter.

## **3.3 Assurance engagements and related services**

The model presented below provides a basic understanding of the assurance engagements and the related services. All auditor services standards have the IFAC Code of Ethics as their basis and International Standards on Quality Control. Audits, reviews and other assurance engagements which are of a non-financial character all provide assurance. But as we can see, not all engagements that are performed by an auditor are assurance engagements. Compilations for example do not offer any assurance whatsoever. Agreed-upon procedures provides assurance based on a very limited area, agreed

upon beforehand by the client and auditor.

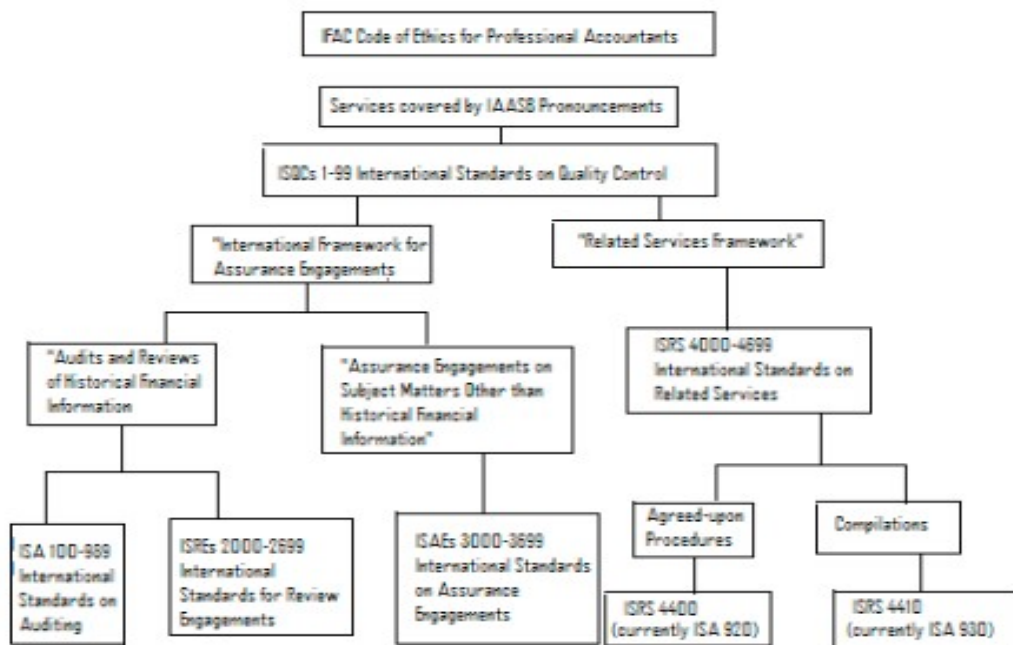


Fig.2 Revised model on Assurance Engagements and Related Services based on Hayes et al. (2004:115)

### 3.3.1 The statutory audit

The audit is a service conducted by an auditor which involves the auditor understanding the auditee's strategies, objectives and risks whilst considering certain accounting policies and audit procedures. Together with the evidence gathered by the auditor, the auditor can examine the auditee through tests of control and substantive procedures for instance. Once sufficient evidence is gathered, enough for the auditor to obtain reasonable assurance, an opinion on the financial statements can be expressed resulting in the audit report (Iwasaki 2008)



Fig 3. The Statutory Audit (by Iwasaki 2008)

According to the framework presented in the Commission Recommendation of 16 May 2002 on the

Statutory Auditors' Independence in the EU, the statutory audit must be carried out by a statutory auditor who is independent from his audit client, both in mind and in appearance (2010m).

Furthermore, to become an auditor in Sweden the Supervisory Board of Public Accountants requires the candidates to pass the national examination of professional competence. By passing the theoretical exam the accountant has proven to have sufficient theoretical knowledge to perform the statutory audit. Also, in order to be admitted to the examinations held by the Board candidates must have passed the theoretical as well as practical education in accordance with Swedish law such as the Auditors Act (2010n).

A ultimate goal of an audit is the protection of all users and stakeholders. The goal of the statutory audit, as stated in the Commission Recommendation, is therefore to express an objective audit opinion. In doing this, the statutory auditor is responsible for performing the audit process in an objective manner, acting fair and honestly. Shareholders of small companies however are often the company's management which makes the audit rather unnecessary for companies with this composition. This argument can further be applied to those claiming that the statutory audit is necessary for auditing a company's internal control. If the company consist of a few members or is family-owned then the statutory again may seem rather time-consuming as well as expensive.

External financiers are often used as an example to represent other stakeholders that rely on the statutory audit when assessing risk to potential clients. Financiers, in the UK, however have over time become more sophisticated in obtaining, analyzing and assessing financial information of small companies without needing an audit (Iwasaki 2008). Perhaps this sophistication will be reached in Sweden too and is rather a matter of time than anything else. The current inclination of Swedish credit institute managers is not as positive as in the UK. According to a study by Swedco/ FAR SRS involving around 80 local credit managers throughout the country, the majority expressed concern facing the market changes due to the removal of the statutory audit. This study found that the concerned parties in general had a negative attitude towards the removal. A great deal of this attitude could be derived from their concern for uncertainties in the future. The confidence in the statutory audit will in essence be the same once the statutory audit is voluntary (2010o).

### **3.3.2 The engagement letter and review engagement**

The International Standard on Review Engagements 2400 (ISRE 2400) was initially issued in 1988 and

later revised in 1990 and again four years later and then reissued as IAS 910. The main purpose of this ISRE is to provide guidance to on the practitioner's professional responsibilities when undertaking a review engagement.

In ISRE 2400 paragraph 8, the review engagement is defined as an opinion providing a *moderate level of assurance* meaning that there is a moderate level of assurance that the information subjected to the review is free from material misstatements. The objective of a review of financial statement is to enable a practitioner to state whether anything has come to the practitioner's attention that causes the practitioner to believe that the financial statements are not prepared in accordance with the applicable financial reporting framework. The main difference here between the review engagement and the opinion in the review is based on procedures that do not provide all the evidence that would be required in an audit (ISRE 2400 §3).

Like the audit, the review should comply with the *Code of Ethics for Professional Accountants* as issues by IFAC. In ISRE 2400 the scope of the review is defined as the

*“procedures required to conduct a review of financial statements” ...”determined by the practitioner having regard to the requirements of this ISRE [2400], relevant professional bodies, legislation, regulation and, where appropriate, the terms of the review engagement and reporting requirements”.*

As for the level of assurance, the audit requires the auditor to assess a *reasonable* level of assurance to the financial information. In the review engagement a *moderate* level of assurance is required to express that the information is free of material misstatements. This concept of the moderate assurance level is one that may be difficult to tackle in practice. The challenge of communicating the limited or “moderate assurance” provided by the review to the users of the report have been expressed by the Auditing Practices Board (APB) in the UK (2010p).

Furthermore, prior to the review engagement certain issues should be addressed between the practitioner and the client and reported in an engagement letter or other suitable contract. Even though though certain issues can be decided on, the responsibilities of the directors to produce true and fair statements cannot be bargained.

In this contract the following should be addressed in order to avoid misunderstandings and to determine responsibilities (ISRE 2400 §12) :

1. The objective of the review.

2. Management's responsibility for the financial statements.
3. The scope of the review.
4. Access to records, documentation and other information necessary for the review.
5. The fact that the engagement cannot be relied upon to disclose errors, illegal acts or fraud.
6. The fact that an actual audit is not being performed and that the opinion expressed in the review cannot satisfy any statutory or third party requirements for an audit.

Another difference between the review and the audit deals with evidence and the obtainment of evidence. In the field study conducted by the APB the issue of evidence is discussed. The report states that on one the main distinguishing factors between the review and the audit is that evidence in the review should be obtained exclusively from analytical procedures and enquiries of directors and not from corroborative evidence. The report goes on to define analytical procedures as procedures which involve comparisons of recorded amounts and ratios to expectation developed by the reviewer. Also the reviewer must understand the financial and non-financial data elements of the client's industry and business. In order for the procedures to be effective the report states that there must be a dialogue between the management and the reviewer. A further concern raised in the report is that concerning the dialogue suggested as it requires a commitment on the management's behalf and may prove to be difficult if the same approach to business is not shared (ibid p14).

### **3.3.3 The compilation engagement**

The International Standard on Related Services 4410 contains information regarding the the compilation engagement. It also provides guidance on the content of the compilation report as well as issues in connection to the compilation. The purpose of a compilation report is to, as the name implies, compile information provided by the client. The official objective is stated in ISRS 4410 § 3:

*“The objective of a compilation engagement is for the accountant to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarize financial information”*

The information which the auditor then will take a part of usually comes from either the balance sheet, statements of income, retained earning or cash flows, or all of the above, depending on the range or scope of the compilation report.

The compilation report is prepared in accordance with national law or international accounting standards but offers no form of assurance and has sometimes even been referred to as a “mini” audit (Smith 2006).



What is important to put emphasis on, when it comes to a compilation report, is that the information expressed in a prepared compilation report only consists of information presented by management. An audit or review of the financial statements has *not* been conducted. Thus the auditor performing the compilation report cannot express an opinion or any other form of assurance to the given statements. The reliance of a compilation report is therefore vague to say the least. No inquiries have been done and the auditor is not able to disclose or detect any kind of irregularities or illegal acts.

### 3.4 Summary of assurance and engagements

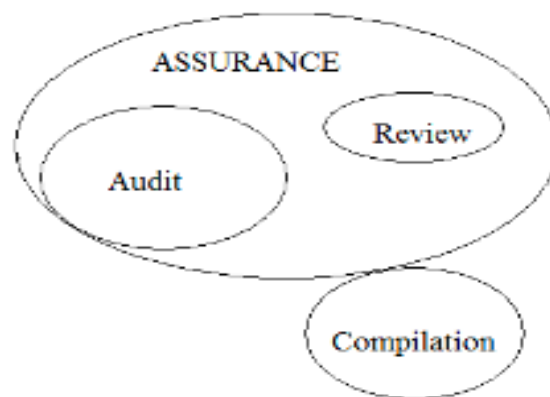


Fig. 4. Model of assurances and engagements (constructed by authors)

To summarize the above sections on the various types of services and engagements and how they all relate to assurance we have created the above model. The main points that should be noted are that audits give a reasonable assurance that the information subjected to an audit is free of material misstatements and are therefore a part of the assurance circle. Reviews are also a part of the assurance circle (presented above) giving a moderate level of assurance that the information subjected to the review is free of material misstatements and therefore represented by a smaller circle than the audit circle. The compilation report on the other hand gives no assurance whatsoever and represents a circle of its own outside the assurance circle.

## 4 Deregulation in foreign countries

*By now, the reader should have a good understanding of what services an auditor can provide, as well as the requirements posed on the auditor by standard-setting organization such as IFAC. The reader should also be aware of the different levels of assurance provided by the various engagements. It is now time for the reader to put this information into a broader perspective, which is why this chapter aims at presenting a historical review of two foreign countries that already have undergone the changes of removing the statutory audit for SMEs.*

### 4.1 A historical review of deregulation in foreign conditions

In this chapter a review of the statutory audit deregulation process in two foreign countries is given. Through a Swedish perspective the deregulation process conducted abroad could bring understanding to what can be expected in a Swedish context. As the EU Commission has only given recommendations rather than binding regulations, the Swedish government should seek to learn from the deregulation processes in the rest of Europe. Perhaps this could give insight on what threshold values should be chosen and how these may affect the rest of society. In 2005 professors Per Thorell and Claes Norberg conducted an extensive study on the statutory audit in Sweden and in doing so also found it useful to look outside of Sweden to understand what may differ between Sweden and the rest of Europe in the process of removing the statutory audit (2010q).

Beside reviewing the historical deregulation process in the UK we have also chosen to present the Danish development as Denmark is one of Sweden's neighboring countries and culturally similar.

### 4.2 The UK

The first requirement for UK companies to be audited came with the Companies Act of 1900. In 1967 the Companies Act introduced a requirement that all company auditors had to be members of a recognized accountancy body in order to raise the standards and qualifications of the auditors.

When the Fourth Directive on Company Law was published in 1978 giving the exemption option to small companies, the UK government first did not take advantage of the option. Those opposed to the audit of small companies argued that it was unnecessary and a costly burden. The purpose of the audit with respect to company's stockholders was not achieved when the company was small and owner-managed. True as this may be, it was decided it still remained in the public interest that companies be audited.

However, as the number of small companies grew with 80 percent during the 1980's the discussion to introduce audit exemption again was brought up. In 1994 it was decided that companies with a turnover of £90,000 or less were exempted from the statutory audit. This threshold was raised in 1997

to £350,000, in 2000 to £1m and again in 2004 to £4,8 (Brandt, McBride, Hines and Fearnley 2000: 300-303) .

It was first in 2008 that the thresholds were raised so that they would comply with those proposed in the EG directive. The reason for doing so was to allow more companies to take advantage of the less onerous accounting requirements available to small companies. Also this meant allowing additional companies to take advantage of the first year capital allowance available to small companies (2010r). The decision to take advantage of the raised thresholds was essentially based on a cost-benefit analysis. For every step in increasing the thresholds it was deemed that the benefits of flexibility and lower costs for companies were greater than the expected temporary risk brought to the profession and market (2010s).

The current limitations for small companies are:

- A balance sheet total less than 2,8 MGBP (32,16 MSEK)<sup>4</sup>
- An annual turnover less than 5,6 MGBP (64,32 MSEK)
- Less than 50 employees

These limits are probably going to be raised even further in the future. The abolishment of the statutory audit in the UK is based upon a regulation philosophy for small companies which basically states that if the benefit of an enforced rule doesn't outweigh the cost it brings, the rule should be removed, a so called cost-benefit-analysis.

Today approximately 900 000 companies in the UK can choose to not have the statutory audit. As many as 60 to 70 percent of these companies have chosen to do just that. This exemption does not however include all public limited companies of any sizes in the UK. They are always required by law to provide a statutory audit. Special rules for the statutory audit have also been applied on business groups. If the business groups annual turnover does not exceed the upper limitations in accordance with article 51, that have been set to public limited companies, both the parent company and the subsidiary are allowed to be exempted from the statutory audit (SOU 2008:32).

Multiple studies on the statutory audit have been made in the UK since its introduction in 1994. In a study by Jill Collis, on request from the chamber of commerce in the UK, a number of conclusions were made as to which companies generally chose to keep the independent auditor even though they were within their rights to decline such an offer from any of the many audit firms. Firstly, these

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<sup>4</sup> Exchange rate as of 01-01-2010

companies usually had a larger annual turnover than companies who chose not to engage a professional auditor. Secondly, the board of directors were in favor of the idea that an independent audit would increase the quality and credibility of the financial reports. Thirdly, these companies ordinarily weren't entirely family owned, and they had shareholders with little or no insight of the company. Lastly, these companies who generally consulted an auditor, every year delivered an annual report to banks and other loan givers (2010t)

#### **4.2.1 Effects of the statutory audit removal in the UK**

Since the removal of the statutory audit for SMEs in the UK other alternative procedures and methods have been introduced in order to allow for a certain assurance on financial information. The most common alternative is the *compilation report*<sup>5</sup> which can be conducted by any person, without any requirements on this person being a professional accountant or auditor. The assurance given in the compilation report is often subject to criticism as the report does not follow any formal regulations concerning the scope of the report for example. For a long time the Public Oversight Board (POB) in Britain has worked towards getting audit firms and organizations to settle on *one* single definition of the compilation report. This, the POB stresses, will lead to less misunderstandings on what the report in fact entails, this in effect will contribute to minimizing the friction between the public's perception of the compilation report and its actual outcome and purpose (SOU2008:32, p173).

Another method introduced in 2006 was the *assurance report* which was designed to be an alternative to the statutory audit and the compilation report. The assurance report, being a cross between the most regulated and extensive audit and the compilation report, was introduced as means of providing companies a variety of methods to chose from. The opinion in assurance report is worded negatively as the work done cannot result in sufficient confidence as in the case of the audit.

### **4.3 Denmark**

The SOU 2008:32 presented the finding of a report conducted by the Danish “Erhvervs- og Selskabsstyrelsen” which estimated that nearly 9 out of 10 companies that fall under the small entity category within the EU are exempted from the statutory audit. It's also important to point out that although many of the countries, who have chosen to exempt companies of these dimensions, also are following the EU standards of the Directive. In some countries though, the legislators have chosen to narrow the numbers of companies by lowering the limits for one or more criteria as they did in

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<sup>5</sup> For an example of the compilation report and the audit report, see Appendix

Denmark upon the removal of the statutory audit of small entities (SOU 2008:32). The administrative burdens on small companies have for a long time been far too high according to a report made by Erhvervs- og Selskabsstyrelsen. Since the statutory audit alone stands for a significant portion of these costs which are imposed on small companies, the Danish parliament voted for a removal of the statutory audit for companies of these dimensions in March, 2006. The decision to remove the statutory audit for small companies was based on the previously mentioned report by Erhvervs- og Selskabsstyrelsen. The report for example contains an analysis on the importance of the statutory audit and how the quality and credibility of the annual report will be impacted upon a removal of the same.

Also financial frauds and tax revenue services were contemplated in the report to make a prediction on how a removal of the statutory audit would change the straightforwardness in small companies annual reports or not. The protection of stakeholders was an important issue when trying to establish how the reporting should take form in the future. In the end when everything was considered it was found that the statutory audit should be removed for the small companies benefit (SOU 2008:32).

In Denmark there are about 93 percent so called B-companies, which is the term used in Denmark for small companies. These companies have few or no employees. A large number of these B-companies have still chosen to continue their annual audits. The effects of a removal of the statutory audit has not had a significant impact on the audit profession as of yet. There is still an ongoing debate in Denmark on how this will play out within the next couple of years. In a study from 2006 it was estimated that approximately 70 percent of the B-companies probably would still get their accounts audited by an independent professional.

Erhvervs- og Selskabsstyrelsen however was not of the same mind. They had in one study come to the conclusion that approximately less than 50 percent of the B-companies would still have their accounts audited by an outsider in the long term (Balans 2007: p.37). Furthermore when the statutory audit was removed for B-companies a debate was held in the Danish parliament to make sure that the boundaries and limits that were depicted would reflect the right amount and sizes of companies. The limitations proposed were as follows:

- A balance sheet total less than 1,5 MDK (2,08 MSEK)<sup>6</sup>
- An annual turnover less than 3 MDK (4,15 MSEK)
- Less than 12 employees

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<sup>6</sup> Exchange rate as at 01-01-2010 used for conversion from DK to SEK

Erhvervs- og Selskabsstyrelsen have however announced that these numbers will be raised in the years to come.

#### **4.3.1.1 Effects of the statutory audit removal in Denmark**

According to Erhvervs- og selskabsstyrelsen, as presented in the SOU 2008:32, there is an immediate need of further defining what exactly an audit implies. This is important to gain understanding, not only because of the removal of the statutory audit for SMEs, but also to enhance understanding companies to which alternatives there are to the audit. They need to be informed about the alternatives to assurance and quality control. In Denmark the statutory audit has not been replaced with any kind of examination or any other kind of control of the annual report.

Companies can only on the shareholders meeting choose to decline an audit of the annual report. And companies who haven't audited have to give information to the tax agency about any assistance from an auditor. The company also have to give information about the annual report and if it's attached to an audit verification. It also has to be explained whether this verification means an audit, review or other kind of assistance. Danish law states that an auditor hands in a report if he or she has assisted in the making of an annual report. This report can, besides an audit, stand for a form of quality assurance and control. However, it will not hold the same high standard as an audit. The company can also make a compilation of the financial statement with assistance from an auditor. The monopoly situation resides within the profession when making these kinds of reports. The Danish tax agencies have, due to this new law, altered their strategy and have started more extensive testing. Before the next level of limits will take place, which has been preliminary set to 2009/2010, the consequences of the removal of the statutory audit for SME:s will first be evaluated. Firstly, the effects on economic crime will be evaluated.

- A balance sheet total of less than 29 MDK (40,12 MSEK)
- An annual turnover less than 58 MDK (80,24 MSEK)
- Less than 50 employees

One study conducted during the preliminary stages of the reform in Denmark showed that roughly 35 percent of the concerned companies were willing to continue with audits rather than the proposed reviews. Surprisingly enough once the statutory audit was lifted 93,5 percent of the companies decided to continue with their statutory audits despite their previous plans (Balans 2008:2, p13). What this denotes, according to Skough, is the strong position of the auditing tradition in the Danish economy. This raises questions of comparability to the Swedish economy: Will as many companies in Sweden keep their statutory audits?

## 5 Swedish historical review

*In this chapter a historical review of the statutory audit in Sweden is presented. In the previous chapter the reader learnt about two countries that have removed the statutory audit for SMEs. Here, the reader will be able to read about audit regulations from a historical perspective.*

### 5.1 A historical review of auditing in Sweden

The rules of audits go back to the year of 1895 in Sweden. This was the first time audit regulations were introduced through the Swedish Companies Act. All limited companies were ordered to appoint a suitable person who would review and check the company's accounts and the administration of the board itself (Thorell and Norberg 2005:15). The suitable person was not forced to have a specific requirement regarding the competence and was named a reviewman. It wasn't until the year 1912 that the Stockholm's Chamber of Commerce decided to authorize professional auditors and in year 1930 they started to approve the reviewmen. Once the reviewmen was approved it meant that they could perform auditor assignments as a sideline and high requirements were not set as to those for the authorized auditors.

#### 5.1.1 The Swedish Companies Act of 1944

In the law of 1944 regarding limited companies it was prescribed that the auditor, amongst other things, should review the company's accounts as well as making sure that the company's organization and control of the bookkeeping and the administration was satisfying. For companies with a share capital or maximum capital of at least 2 million SEK and companies whose shares or bonds were noted at the stock exchange, a requirement was introduced stating that those companies should have at least one auditor who was authorized by the Swedish chamber of commerce.

#### 5.1.2 The Swedish Companies Act of 1975

When the Swedish Companies Act changed in 1975, it also brought the obligation to have a qualified auditor that would include all limited companies with a higher restricted equity than one million SEK and limited companies where the owner that has a tenth of the shares has demanded so at the shareholder's meeting. These companies should have at least an authorized auditor or an approved auditor. The concept an approved auditor replaced the approved reviewman. In the preparations to the law it was stated that a competent and independent audit in the larger companies was something that

needed to be secured. At this time it wasn't considered necessary to have an authorized or approved auditor in the smaller companies. It was considered that in the smaller companies that had easy business relationships, the audit would be performed relatively easily without the theoretical knowledge of authorized and approved auditors. A demand for smaller companies to have authorized or approved auditors would only result in an unnecessary cost for the company. Furthermore, the number of authorized and approved auditors were not that many in this time.

During the 1970's there was an intense political debate in Sweden about economic crime. It was claimed that the economic crime involved twice as bigger amounts than the traditional crime, and that the society's preventive measures had a wrong direction and appeared to be insufficient and that the society's control and penalties weren't designed for the struggle against economic crime. In a memorandum from a working group within the Crime Preventive Council, the statement of auditors involvement in the economic crime was rejected and instead they began looking into and investigating the possibility that economic crime could be counteracted through the effort of competent and serious auditors. Some of the suggestions that were presented ultimately led to legislation in the year of 1981, which involved that the auditor should have an information responsibility to his co-auditor, new auditor, particular reviewer and bankruptcy manager.

In 1978 Crime Prevention Council's memorandum the working group left a recommendation that all limited companies should be obliged to have at least one qualified auditor, but at the same time it was established that it couldn't be done immediately since the qualified auditors were too few. Since the least allowed share capital would be increased to 50.000 SEK in 1981, it was therefore assumed that the number of limited companies would decrease strongly within the following years. It was therefore suggested that an obligation for all limited companies to have at least one qualified auditor wouldn't enter until January the first of 1982. The working group also made the statement that the obligation would have an impact in the long run for all the economic activities. The proposal of a general obligation to have a qualified audit was handled in a government bill in 1980. In the government bill it was mentioned that the smaller companies were more exposed to economic crime and that an effective and competent audit is important even in the smaller companies in order to counteract and prevent economic crime. In regard to the fact that there weren't enough qualified auditors, the question had to wait until the number of limited companies had substantially went down.



### 5.1.3 The Swedish Companies Act of 1983

A couple of years later it was suggested by an estimate of the number of auditors that all limited companies should have a qualified auditor. As a reason for this, it was mentioned that it's obvious that a competent and effective audit would have an impact in fighting the economic crime and other irregularities that can occur in a company. In relation to the parliament's treatment of the bill it was decided that the reform should take effect for newly formed limited companies in January 1983, and for older limited companies from the first regular shareholder's meeting that was held after the end of 1987.

The government appointed a Commission against economic crime which presented a paper on more effective auditing in 1983. They suggested that the auditors should in their reviews examine how the companies fulfill their obligations according to tax- and fee constitutions and remark on lacks in these areas in their audit report as a way to make the audit more effective against economic crime. A review obligation was considered to have positive effects on fighting the tax evasion and other economic crime as well as tax escape. The Commission also made the conclusion that there were no reasons for introducing the order where the society would appoint an auditor to the companies. It was considered that most companies were working properly, as a whole, and an order where there would be public auditors would require too many resources. Instead it was suggested that the society under certain circumstances, such as when the company isn't handling their bookkeeping or their payments properly, should have the right to appoint an auditor. The Commission's suggestions on the auditors review of the company's obligations when it comes to taxes and fees ultimately led to a legislation in the fall of 1984.

The number of limited companies increased tremendously during the 1980's, and so too the number of qualified auditors. The transition to the new order of having qualified auditors in all limited companies did not seem to have caused any greater problems or difficulties. The political debate regarding economic crime decreased during the 1980's but lifted again during the beginning of the 1990's, after the financial crisis. There was a new demand now for the society's resources to gather and fight the economic crime as the economic crime has risen and was becoming a big problem in society. The parliament's auditors found it important to enhance the risk for detection and strengthen the common responsibility for the appliance of the rules in the society. It was found that the company's auditors had not been able to prevent the bookkeeping crimes that were involved in economic crime. Also the combination of control and advisory services was perceived as complicated and ultimately affected the auditors trust position in relation to the members of the board and external parties. In this way an

expectation gap has been formed, reflecting society's expectations at one end and the auditor's abilities to match these expectations and to perform at the other.

The first of July in 1995, the Supervisory Board of Public Accountants in Sweden (Revisorsnämnden) was introduced as a way of monitoring the qualified auditors according to the new auditors law that was introduced simultaneously. The purpose was to set a mark to the society about the meaning of the auditor in the struggle against economic crime. In 1999, on January 1st, the obligation for auditors to leave his/her assignment and report to the prosecutor if a member of the board or the CEO had committed an economic crime was introduced.

Regarding the smaller limited companies and their obligation to have an auditor it was still found important since it's of a great deal for the shareholders to have a competent and independent auditor to ensure that the company is working properly. It's also important for the company's creditors, their employees as well as the public interest. The emphasis is also on the fact that if there wasn't an obligation for smaller limited companies to have a qualified auditor, there would be a risk of the economic crime to increase in these companies (Thorell and Norberg 2005:15-17).

#### **5.1.4 The Swedish Auditors Act of 2001**

This Act (2001:883) defines the basic concepts such as the auditor, the approved public accountant and the audit firm. By defining these, the Act also sets requirements on each such as that of auditor independence on the auditor and the professional duties of an auditor. This Act also contains information on disciplinary measures in the cases that an auditor intentionally acts wrongfully or dishonestly ultimately leading the auditor's authorization being withdrawn. This Act came into force on 1 January 2002 (2010u). The Auditors Act (2001:883) is complemented by the Auditors Ordinance (1995:665) which contains provisions for the Auditors Act. Here issues such as auditor approval and authorization including qualification are explained further (2010v).

#### **5.1.5 The Swedish Companies Act of 2006**

The Swedish Companies Act in 2006 didn't bring any changes regarding the auditors responsibilities and obligations. The company's annual reports and accounts were still required to be reviewed by one or more auditors (Ministry of Justice, 2005). The Act of 2006 did however contain certain changes concerning the term of office of the auditor. Apart from this no substantial changes were made concerning company audits.

However, in 2007 the obligation to have an authorized or approved auditor was instead formed with

regard to number of employees, turnover and the balance sheet total. To conclude the discussion of the auditors role in Sweden, we have seen that their obligations have increased as well as the monitoring of them. Auditors are fundamental, especially in times of financial crisis. The current debate now refers to the change towards ending the obligation for small joint-stock companies to have a qualified or approved auditor, taking us back to the system before 1983.

## 6 Current debate in Sweden

*With the background given in the previous chapters, the reader is now expected to be able to understand the current conditions influencing the current debate. By now, the reader should have a good understanding of both the theoretical and historical sides concerning the removing the statutory audit for SMEs in Sweden. This chapter is aimed at giving the reader an update on the current situation.*

### 6.1 Prominent contributors to the debate

As the removal of the statutory audit affects so many government authorities and other parties, all the affected can be said to play a role in contributing to the current debate. On an international level of course governments, and other major standard-setters such as IFAC can be found. On a national level quite a few contributors and stakeholders can be distinguished. Just by examining the official comments in response to the SOU 2008:32 report we can find many actors that have a special interest in the outcome of coming proposition.

A prominent contributor to the current debate from a medial perspective is Balans. Balans is a Swedish periodical and a major supporter of the free and unbound debate regarding auditing and accounting. The journal is published ten times a year by FAR SRS, the organization for advisors and auditors. The issue of independence in the audit profession is an important one and is often discussed in Balans along with more in depth articles on the ongoing Swedish convergence of regulations to international standards. In order to appeal to a broad public, such as in reality where the accounting and auditing sectors are best described as multifaceted, Balans makes efforts to dive into specific subjects, as well as commenting on technical and practical applications and the academic debate. However technical and complicated the matters brought up are, Balans makes a point of keeping it simple in an effort to appeal to the broader public. Here we note the some contributions from Balans and other reports that have influenced the current debate (2010w).

### 6.2 Time for a change

There have been rumors made regarding the timing of the removal of statutory audit for SMEs and that it should be postponed because of the financial crisis. But now seems to be the perfect time to do this change. The customer benefit of auditing will be in focus instead of it being considered as a burdening cost for the smaller companies. Everyday companies are facing the questions of what is happening and there is an anxiety about the future and what it holds, during this financial crisis. They are worried about not catching the signals on time in order to make accurate judgments in order to run

their company successfully even in a recession. It's in these times that the company's owners and management are appreciating the value of having qualified knowledge and are willing to pay for it. It's now that they need qualified competence to be able to estimate risks and important things in the company's activities and preferably from someone outside the company (Ahlberg 2009, Balans)

Some company owners already realize that getting external support is crucial for the continuing success for the company. Trustworthy financial information is the foundation of all business activities, and in times of anxiety there is a bigger distrust to the numbers that are presented and uncertainty in the liquidity flows contribute to increase the anxiety. The customer, financier and the supplier will demand access to current quality approved financial information. This discussion leads us to the importance of the timing of the removal of the statutory audit for SMEs. What better time to do it then now when the need for quality approved information is as most (ibid).

If we look at the trend for many companies today, it's to outsource as much of the administrative work as possible. They leave it to the accounting consultant or the auditor to help out with the closures, etc. They possibly handle their own bookkeeping. Now that the SMEs can decide whether or not to have the auditor's help it will more likely mean that the companies will still be dependent on the auditor. The change will possibly be a benefit for the auditors and the accounting consultants. They now have the role of insuring that the companies financial reporting is quality approved, much like the task before the change ( Börsvik, Magnusson & Prytz, 2009 Balans).

### **6.3 The audit firms**

The removal of statutory audit for SMEs deals with the increased opportunity for the audit firm to also work with accounting services. This combination of assignments will generally lead to a high quality when it comes to the accounting. Auditors from Denmark and England, are considered to be independent when assisting smaller companies with combination assignments, and have in doing so not met any problems (Brännström, 2009 Balans). On the contrary, if it's better to have combination assignments, then why not introduce these rules even to the large and public companies? Andersen was one of the auditing firms that disappeared after they had lost the trust and broken the boundaries with the company. (Ribbestam, Steve Balans) So there can also be disadvantages with this type of combination assignments where it's important for auditors and the audit office to always have in mind if they can make/give a clean and independent audit/service.

## 6.4 New skills required

In order to become an approved or authorized public accountant, the Board of Public Accountants has stipulated certain requirements and examinations that all candidates must pass before receiving approval. The examinations ensure that the candidate has both a theoretical and practical knowledge to perform a statutory audit. These requirements have in light of the EU harmonization process also been subject to discussion once the statutory audit is removed and the the number of auditor assignments are expected to be reduced. In the January issue of *Balans* 2010 this question is discussed, the authors discuss the need for a modernization of the requirements placed on public accountants. The problem the authors refer to concerns SMEs who are looking to employ accounting consultants who can focus on the operational and practical needs of the company rather than the more theoretical authorized public accountant. The authors conclude that the requirements on the accounting consultants should not be the same as for the authorized accountants and that KY<sup>7</sup>-educations in the future should in this respect focus more on educating students who will be able to work as authorized accounting consultants. (Edsbäcker, et al. 2010) This essentially means that the interest in becoming an authorized public accountant will most probably decrease as accounting consultants will be able to take on more tasks formally provided by the authorized public accountant.

The transition to voluntary audit for SMEs, the increased guidance and the importance of describing the customer benefit of auditing and guidance industry's services will mean that new services will be introduced. The staff will have to change and coworkers with the wrong profile will be exchanged to coworkers that will have new competence profiles. An increase in the competence development of existing coworkers who are willing to take on this challenge to change their working ways can be expected. It's expected of the future auditors and advisors to be able to communicate their services as individuals.

It's not enough to have good marketing departments, every coworker must be able to show the customer benefit of his/her services. For coworkers who are already in the business, competence development will be crucial within new areas such as communication and sales. Popular coworkers will be those that can deliver what the customer wants, that is those coworkers that can describe the customer benefit and show the values for the company's owners. It's three things that companies are willing to pay for and this is something that every coworker within the auditing and guidance industry should know. It's security, credibility and trust in the numbers that are presented. (Ahlberg, 2009, *Balans*)

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<sup>7</sup> A Swedish KY-education is equivalent to Higher Vocational Education and is governed by the National Agency for Higher Vocational Education. Courses provided are tailored for the needs of the labour market.

The number of auditors in Sweden has decreased over the past year. The removal of statutory audit for SME:s is of course leading to a decrease in the profession in the long run, but since the decrease is visible now it's a bit alarming since this indicates that the reform suggestions are getting powerful and have an impact way sooner than predicted. (Strömberg, Peter Balans)

Jörgensson and Stensjö conducted a study on the future requirements on auditors and accounting consultants once the statutory audit is removed for SMEs. According to this study more than half of the auditors and accounting consultants stated that they would need more education before the change was introduced, above all in traditional areas such as tax, auditing and accounting. Only a third of the respondents considered themselves needing education in areas such as sales techniques, marketing and presentation techniques. Half of the respondents considered the change to be a positive for their profession. They also considered that there would be more time over to focus on quality and other issues that could be important for the customer. Only a small percentage of the respondents considered the change to be a threat, mainly because they were concerned that accounting offices would consider auditing as an unnecessary cost and therefore not recommend audit services to their clients. Another factor was that the prices would decrease for audit firms since accounting offices would have lower prices and therefore compete with them. It's primarily auditors that will be affected by the change, but since the accounting consultants may face with an increased competition once more auditors become accounting consultants they might be affected too. (Halling, 2010 Balans)

In conclusion, the removal of the statutory audit for SMEs will most likely change the demand and needs for accounting and auditing services, influencing the whole profession and its structure. As the market becomes more demand-driven the professionals in these sectors will have to become more flexible in the range of services they offer. One thing is certain however, the roles of the auditor and the accounting consultant will somewhat converge in order to deal with the changing demands posed on them (Halling 2010).

Halling exemplifies the convergence with an example from Värnamo, an example that reflects the convergence. In a small auditing office in Värnamo, with 20 employees, the change might have a great impact on them. Kenneth Malm is an auditing partner in the auditing group in Värnamo and he says that most of their customer's don't even know the difference between an auditor and an accounting consultant. The customer is mainly interested in feeling confidence and trust in the person performing the service. For their office he considers it mostly important to have further education in areas such as presentation technique and sales technique. (Halling, Pernilla Balans)

## 6.5 Cost savings and quality control

The aim is that the company's competitiveness should be reinforced. In order for this to be achieved costs for administrative burdens should be cut by 25%. These cuts should in turn emancipate resources for marketing inputs such as product development, etc. The possibility for smaller companies to choose if they want an audit or not as well as the demand for information in the annual reports, is not considering the fact that the demand for information should substantially be equal for all companies irrespective of the size. (Skough, 2009 Balans)

The discussion is also whether the cuts are really going to be made. The company's transaction costs are going to remain, it's more about the company's themselves deciding on how they are going to create trust to their shareholders and where the cost for this work is going to end up. Quality is a concept that always costs and regarding the financial crisis we are in now, there is probably no one prepared to lower the quality demands for the company's financial reporting system. On the contrary, the market will most likely increase the demands of control in the company's activities ahead, irrespective of the company's size. This is of course done in the intention to strengthen the confidence in the company's transactions (ibid).

The assumption that the removal of the statutory audit for SME: s is going to lead to savings and simplifying for the companies is somewhat doubtful. As mentioned, the savings will probably be invested in marketing developments and the companies will experience the simplifying as somewhat too complicated and that the companies should have more responsibility regarding the trust being maintained by the market for the company (ibid).

## 6.6 Economic crime

In a special report on crime presented by the Crime Prevention Council (2006:1 p.18-19) economic crime cannot be labeled through a particular offense, instead it should be seen as an umbrella term for several different crimes, such as embezzlement, tax law violations and violations of certain Acts such as the Companies Act. What however characterizes these crimes are that they are difficult to detect and detecting them is a matter for societies control mechanisms. In the study "Right from the start" by the Swedish Tax Agency the economic criminal is described (ibid. p.79) as a:

*"..a man in his forties...a Swedish citizen and owners of a small business. He has no previous criminal convictions or has had legal proceedings commenced against him on only very rare occasions."*

This definition is based on the findings of the Crime Prevention Council from 1996. The rapport states that these typical characteristics are still valid. The majority of persons convicted of economic crime



are in other words middle-aged men who have committed economic crimes in a business framework. With this understanding of who the typical economic criminal is and what kind of fraudulent acts he engages in, society has a better chance of detecting this crime.

Finally the report also stresses the preventive work of the Tax Agency in preventing crime and the importance of detecting economic crime at an early stage as there seems to be a link between tax crimes and other economic criminality. For this reason the Tax Agency depends on the cooperation of other authorities such as the police authorities and the Economic Crime Authority (*ibid.* p. 81).

## 7 Swedish legal framework

*In this chapter the process leading to the new law is presented. This shows the reader exactly in what stage of the process we currently are in. Furthermore, an executive summary of the SOU2008:32 report is given along with official comments from the Swedish Tax Agency, Economic Crime Authority and FAR SRS.*

### 7.1 Process leading to a new law



Fig 5. Swedish law-making process model by Ministry of Justice.

At the first stage we have the initiative for change where it's the government that initiates most legislative proposals. Some bills may be based on suggestions from private citizens, suggestions put forward by the Swedish parliament, public authorities or special interest groups. Before the government can actually draw up a legislative proposal, the matter first has to be evaluated and analyzed. The government usually appoints a special expert or group which is named an inquiry that takes a closer look at the different questions that are involved. These so called inquiry committees work independently of the government, but the minister concerned however appoints the members of the inquiry committee. These members are experts in different fields such as politicians or public officials. This committee presents their proposals in a so called inquiry report. These reports get published and automatically become available to the public (2010x).

Before the government actually deals with the recommendations that are made in the inquiry, the report first circulates to relevant consultation bodies for a comment. The bodies may be local government authorities, central government agencies, and non-governmental agencies that may be affected by the proposals. Once they have submitted their comments it's time for the ministry that is responsible to draft a bill to the parliament. The comments from the consultation bodies along with the inquiry report are the basis of this process. Since the government works as a collective, the members of the government had to have reached a consensus before the bill is decided upon. The government is obliged to refer major items that refer to draft legislation to the council on legislation who is a body whose members are judges from the supreme administrative court and the Supreme Court. This consultation is intended to ensure conformity with the legal system. The council is merely a consultative body and not a decision-making one (2010y)

Once the bill is submitted to the parliament, the bill is then dealt with by one of the standing committees. When the committee has completed its deliberations, they then submit a report to the chamber for proposal and debate. If it's adopted then the bill becomes official law. Laws are normally enacted by a single majority decision by the parliament, but fundamental laws must be adopted by way of two identically worded majority decisions by the parliament. Between these two decisions an election must be held to parliament where the newly elected parliament makes the second decision. Once the parliament has adopted a proposed law than the government formally issues the law. This leads to a publication in the Swedish code of statutes (ibid)

### **7.1.1 Executive summary of SOU 2008:32**

The SOU 2008:32 report is the official report issues by the Swedish government concerning the removal of the statutory audit for SMEs. The main issues presented in the report are the following:

1. The inquiry proposes that barely 4 % of the joint-stock companies should be obliged to have an audit. This basically means a transition to what Sweden had before 1988.
2. Today, the auditor is also responsible for reviewing the board of directors and the MD:s administration. The inquiry also proposes that the administration audit should be abolished.
3. The auditor is also obliged to review how the audit client has fulfilled his/her obligations to pay tax and to review if there has been any crime in the audit client's activities. If there is any crime then the auditor should report them. The inquiry suggests that this should be abolished.
4. An auditor is selected for a period of four years where the inquiry now suggests that this period should be shortened to one year.
5. There must be regulations on audit in the articles of association. The inquiry now suggests that the

auditor should be able to be selected by the shareholder's meeting without the support in the articles of association. The old articles of association regulations regarding audit should cease to be valid without the shareholder's meeting having to make a decision about it.

6. The inquiry suggests that the new regulations should come in force on the 1<sup>st</sup> of July 2010, and be applied the first time to the fiscal year beginning after the 30<sup>th</sup> June 2010.
7. The inquiries suggestions are reckoned to decrease the company's costs for audit with 5, 8 billion Swedish crowns per year. (SOU 2008:32)

The positive effects for those companies that will be released from the obligation to have an audit are that it will lead to significant cost savings. Once the obligation is abolished, the smaller companies will have freedom to choose for themselves what kind of accounting- and auditing services they might need. The supply on the market for these services will be more varied and this will ultimately lead to a decrease in the prices for these services. This is expected to give better conditions to meet the hard competition from companies that today don't have an obligation to have an audit or have lower costs than the Swedish companies for audit. (SOU 2008:32)

The negative effects are somewhat hard to quantify and the alleged negative effects of removing the statutory audit for SMEs is the worry that auditors feel about the prospects of losing a monopoly condition and being exposed to a hard competition in a market that is in a rapid change. The Tax Agency and the Swedish Economic Crimes Bureau also point out the possibility that tax errors will increase and that the economic crime will spread out if the removal of the statutory audit for SME: s will happen (ibid)

The report has analyzed the effects the removal of statutory audit for SMEs might have on the tax income size. The connection between the statutory audit and the quality of the company's information statements and declarations are however still uncertain and the effect is therefore unclear. There is also uncertainty concerning the extent to which the smaller companies will choose the voluntary audit despite the exemption offer. To compensate for the loss of control once the statutory audit is removed the report has proposed two measures. First of all it is suggested that the Tax Agency in Sweden should have the opportunity to make random public controls of the company's bookkeeping and other accounting information during the year. Through these random sample test the Tax Agency will be able to make quick and effective checks in the accounting area. Secondly, the inquiry suggests that there should be a regulation stating that all business owners should leave information in their income tax returns stating whether their annual closures have been established by assistance of an assignment taker and if the accounts have been audited by an auditor (SOU 2008:32).

The suggestions from the report are based on the underlying assumption that auditing is useful. On the contrary, the inquiry also suggests that audit service mostly provides a value to the audit client. The traditional and mandatory statutory audit means that clients were not given the decision to choose for themselves whether they wanted to buy audit services from the auditing firms based on their needs and wants. An annual fee was paid for an audit that the legislator deemed necessary and that was basically the same for every company, regardless of the client's company size.

The inquiry suggests that the removal of statutory audit for SMEs will lead to companies deciding for themselves if they want an audit or not and also what kind of audit they want. This may well lead to a sort of modernization in the market of accounting and audit services, meaning that more focus will have to be put on offering attractive services and more on the advertisement of these services (SOU 2008:32).

### **7.1.2 Different threshold values**

Another issue raised in the SOU 2008:32 report deals with the threshold values that must be stipulated. The report stated that the process of determining a set of threshold values was difficult as they had to be easy to enforce but hard to manipulate. Also consideration had to be given to the benchmarking need, meaning that the thresholds had to be chosen so that they easily could allow for comparisons between Swedish and foreign companies. Furthermore, the Swedish thresholds had to be chosen so that they could easily be adjusted if the EU's threshold values were to be changed. The inquiry also states that if the company's costs regarding audits, are to be cut by a quarter in three years, then the circle of companies that are going to be exempted shouldn't be too narrow.

The lowest proposed threshold values that are to be considered are:

- A balance sheet total of 1,5 million SEK
- An annual turnover of 3 million SEK
- Number of employees 3 (SOU 2008:32)

If the threshold values are set in this way, the statutory audit will include 95 000 limited companies, which is not more than just a third of the total of 260 000 active limited companies in Sweden, today. On the contrary, about 165 000 active joint-stock companies and about 70 000 resting joint-stock companies that today have an auditor, will be able to choose if they want an audit or not. (SOU 2008:32)

With the threshold value set at this level, the considerations of putting the threshold values higher are weakened. Those companies that are next in the size order are the ones that have more than 3 million SEK in annual return, more than three employees and more than 1,5 million Swedish crowns in the balance sheet total. The number of employees gives an indication that the company has reached a critical point and needs to organize their accounting, income-tax return and tax payments in a securing way. Those companies normally also want to grow, maybe with the hope of someday being sold to another company. In this situation the company has a strong incentive to have their accounts in order and receiving help with tax-income returns and tax counseling. If the obligation to have an audit is removed for these companies, it can be expected that the majority of them will still rely on the economic services that they consider themselves to need and will therefore choose to have an audit in the way that they are used to (SOU 2008:32)

Since the inquiry does not analyze threshold values above the lowest proposed, the next question is whether the Fourth Company Directive maximum values should be selected instead.

- A balance sheet total of 4,4 MEUR (45,3 MSEK)
- An annual turnover of 8,8 MEUR ( 90,6 MSEK)
- Number of employees 50

In the enquiry document it is stated that Swedish companies are currently in a weak position on the competition market compared to companies in England, Germany and Holland because Swedish companies are forced to have more cost demanding accounting and auditing services. This weak position will worsen if Sweden now decides to have lower threshold values for the statutory audit than those that are used in leading countries within the EU. The development within the EU will most likely mean that the boundaries for the statutory audit will probably increase further and that more countries than previously will choose the maximum values for exemption of the statutory audit. Because of this concern, the inquiry suggests that all companies that are beneath more than one of the 4th company legal directive threshold values will be exempted from statutory audit. This will lead to a threshold value in Sweden at:

- A balance sheet total of 41,5 MSEK
- An annual turnover of 83 MSEK
- Number of employees 50

The inquiry suggests that the same threshold values should be applied for all forms of associations and for all groups of companies. It is also suggested that all companies listed on the stock market and most companies in the finance- and insurance markets should be obligated to have at least one qualified auditor.

### **7.1.3 Consequences**

In order to be able to somewhat estimate the consequences of the removal of the statutory audit; we first must analyze who it is that actually needs an audit. The simple answer to this is everyone who needs the company's external accounting. The audit is supposed to satisfy a number of different, sometimes contradicting, interests. In a market economy owners and capital placers put risk capital at a company's disposal. They therefore need economic information which can be put as a base for decisions regarding buying, selling stocks or other shares in the company. With the removal of the statutory audit for SME: s this will ultimately lead to a worsening in the possibilities for control for owners that don't have a determining influence in the company. The credit givers need information in order to be able to judge if the company has the ability to pay the agreed amortization and interest. The demands both capital placers and credit givers have on security regarding their money will probably be sharper for companies that don't have an auditor whilst the terms for the loans will worsen compared to today. The credit giver doesn't have an obligation to grant a credit and can demand that a company has an auditor or some other external assistance at the establishment of a closure before the credit application is tested. The costs for this type of review will of course be paid by the one that is seeking the credit.

The suppliers of a company need to test if the company can pay for the delivered merchandise and service on the payment day. With the removal of the statutory audit for SMEs in the case of the suppliers, it doesn't really play a great deal since suppliers have different solutions when it comes to payments such as a guarantee, pawn, leasing, etc. They are most likely not that interested if a company has an auditor or not. In cases where two companies buy from one another there can be situations where expensive material is sold that the customer might require that the company has an auditor, since it's important for the customer that the company is going to be there for a long time due to guarantee issues and repairments.

Ultimately the public also need economic information about a company in order to determine tax basis and the final tax. Of the above mentioned parties, the primary ones are the capital placers and credit givers since they are the ones mostly affected by the company's economic numbers.

To summarize, auditors will lose income due to the fact that some companies will choose not to take on their services anymore. After some time, when the current statutory audit for SMEs has been forgotten, the companies tendency to choose an auditor will decline even further depending on the fact that stakeholders will be offered alternatives to an audit on the market that the audit clients will consider to be more price worthy and that can better be adjusted to the company's specific needs and requirements. In many of the companies that have a higher turnover, many employees and several owners the credit givers will most likely put a demand that they have voluntary audit. One has to take into consideration that once the removal of the statutory audit for SMEs take effect, there will be a high surplus of auditors until the range and demand on the audit market has come in a balance. During these years the surplus of auditors on the market will pressure down the prices on the audit services.

When it comes to audit profession, the work will change for many auditors. Some will continue doing the work that they are doing now, and some will aim at smaller companies offering them voluntary auditing and other, more simpler auditing service for quality assurance of the financial reporting such as reviews and compilation. Reviews meaning an analysis being performed of the financial reporting and on the basis of the analyses a review report is given. A compilation means that the person/bureau that has assisted a company with putting together a financial reporting will confirm this through a certificate. Some other auditors will instead of statutory audit specialize and offer qualified tax counseling or assists with company counseling such as risk management, corporate development, restructuring and finance. Some will go to other employments such as within economic departments in various companies or governmental authorities. In the long run however, the number of auditors will probably decrease.

The range of services that will be on the market if the removal of the statutory audit for SME: s is to be in place, follows a great deal of concern. Mostly because of the increased competition that will take place in the market for accounting, tax consultation, company counseling and similar services. In order to be able to meet this increased competition, it most likely that many accounting- and auditing firms will join forces or increase their cooperation to be able to achieve cost advantages in this way. This process has already begun where big auditing firms have begun buying up smaller accounting firms.

Ultimately, the negative effects are hard to quantify where the alleged negative affects as presented above mostly focus on the worry auditors feel about the forecast of losing a monopoly position and being exposed to a hard competition on a market in a rapid change.



The tax authority and the economic crime authority point to the possibility of tax errors increasing and that economic crime will spread if the removal of the statutory audit for SMEs is to take place in Sweden.

## **7.2 Official comments on SOU 2008:32**

As a step in defining a new law concerning the removal of the statutory audit various parties were involved in giving their comments on the inquiry. Here we have chosen to present a summary of those relevant to this study. We have chosen

- FAR SRS
- The Swedish Tax Agency
- The Swedish Economic Crime Authority

### **7.2.1 FAR SRS**

As the main branch organization for auditors and advisors, FAR SRS, is positive to all initiatives that entails greater responsibility and also freedom in the business sector. Removing the statutory audit for SMEs could well be an initiative that allows for such a development. However the consequences and effects of such an initiative should be carefully analyzed before taking further action. According to FAR SRS the current reports on the consequences for both society, on a broader scale, and the actual business sector are insufficient and not yet convincing enough for the FAR SRS to give their full support.

FAR SRS supports the proposal concerning the auditors obligations in reporting and acting on suspicion of economic crime as presented in the SOU 2008:32 report. Furthermore, FAR SRS supports the opinion that the auditors mandate be shortened from the current four years to one year. Also, if the statutory audit is removed for SMEs the FAR SRS is of the opinion that if an auditor is employed by a company this should be stated in the annual audit and financial statements.

FAR SRS does not support the proposal allowing the Tax Authority to perform sporadic public inspections of the company's bookkeeping and other financial information during the fiscal year. Also in general the FAR SRS is against the limitations proposed in the SOU 2008:32 report. Instead of setting the limitations at the EU's maximum values the alternative limits presented should be applied, at least at the first stage then gradually raising the limitations in time. Concerning the overall estimated cost savings presented in the report, the FAR SRS questions whether the removal will entail any savings

at all as the concerned parties will still have to spend resources on achieving quality and assurance on the financial information presented even when the auditor may be removed.

### **7.2.2 Swedish Tax Agency**

The Tax Agency does not support the proposals made in the inquiry to remove the statutory audit for SMEs. The main reason for this being that Tax Agency believes that the preventive effect of the auditor has been greatly underestimated in the inquiry. The Tax Agency believes that removing the statutory audit for SMEs will increase both intentional and involuntary misstatements in income and tax declarations. The main issue for the Agency concerns the quality of the statements sent to them. If the statutory audit is to be removed the Tax Agency deems it necessary to implement compensating measures to ensure that the quality of the financial statements presented, thus reducing the risk of increased tax fraud. Furthermore, if removed the Tax Agency will have to increase its efforts to ensure that errors and misstatements reported to the authority are detected at an early stage as the income and tax declarations are based on these reports. In order to do so the Tax Agency will have to rely on greater financial resources.

Concerning the proposed limitations the Tax Authority believes that if the limitations are set at a balance sheet total of 1,5 million SEK, net sales worth 3 million SEK and a total of 3 employees, tax fraud will be highly affected. As the Tax Agency assesses that the risk is greatest for micro and smaller companies to commit tax errors the limits should be set as low as possible thus reducing the number of companies affected by the proposal. These limits can in the long run be raised but should at first be set very low in order to reduce the risk of tax fraud.

Regarding the cost reduction and the expected savings from removing the statutory audit the Tax Agency is sceptic. According to the proposal the current statutory audit system costs SMEs almost 6 billion SEK each year. The removal will certainly be more cost efficient for SMP's but will also mean that this costs will be shifted. The Tax Agency's costs will increase as the control function earlier performed by the auditor will have to be taken over by the Tax Authority. The key argument for the Tax Authority is that if the authority is to perform its duties and obligations as before then current systems, structures and routines will have to change. The overall effect will be a cost and responsibility shift from companies to authorities.

For these reasons the Tax Agency will require extra financial resources in order to cope with the changes, an estimation of the extra fundings lead to a total of at least 100 million SEK. The Tax

Agency believes that these extra resources are a prerequisite for a fully functioning and effective working environment in the future.

Furthermore, as the removal of the statutory audit for SMEs will lead to changes in the actual services performed by accountants and auditors the Tax Agency proposes that the government be more engaged in the future of these services. The Tax Authority believes that as these services will change the government should set specific requirements and demand certain qualifications for those in the market for consulting services. One such step has already been taken by FAR SRS in the development of an authorization institute for accounting consultants and also through the establishment of Reko (the general standard for accounting consultants). The Tax Agency believes that such initiatives will contribute to a clearer structure in the accounting and auditing sector.

### **7.2.3 Swedish Economic Crime Authority**

The Swedish Economic Crime Authority works to detect and prevent economic crime, for this reason the bureau supports the initiatives to simplify the regulatory framework posed on SMEs. This simplification will contribute to the creation of new companies which will benefit the society as a whole. For the bureau a simpler regulatory framework will support the overall goal of the bureau which is to prevent economic crime.

The bureau feels that the regulatory framework posed on companies should be simple in the sense that companies should be able to understand rules and regulations without the interference of an auditor. Furthermore by making the regulatory framework less complicated companies are likely to better understand the rules posed on them and less likely to commit errors due to misunderstandings. The bureau supports the belief that economic growth entails competition on equal grounds to all services however to minimize the risk of unfair competition functioning control mechanisms are essential. One of the control functions needed in this respect is performed by the auditor.

Despite this positive support the Authority feels that removing the statutory audit in 2010 would be too hasty. The Authority considers that too little time has been spent on studying the potential consequences this radical change entails. For one, the auditor's role in preventing economic crime has yet to be deeply researched. The results of such a study would of course benefit the Authority but also the society as a whole as it may have an effect on fair competition.

An important prerequisite for the Authority in detecting and preventing crime is that there are functioning control mechanisms. In the current structure the auditor plays an important role in detecting and preventing fraud. Removing the auditor means also interfering with the entire control mechanism structure which effects are yet to be seen.

One of the benefits discussed in removing the statutory audit concerns the cost-benefit tradeoff for SMEs. The Economic Crime Authority does not support the opinion that the removal will mean less costs for the concerned companies. The potential cost reduction per company is considered to be margin and thus so too the proposed savings effect in whole.

The SOU 2008:32 inquiry proposes to eliminate the auditor's obligation to report economic crime and fraud. The Economic Crime Bureau does not support this proposal as it is solely motivated by an international harmonization obligation not taking into account the positive effects this system has had in Sweden. Reforms such as the one proposed take time to implement and requires a longer perspective. Also, as the proposed reform effects so many parties it would be necessary to construct and implement new routines. Regarding the auditor's obligation to report economic crime the Economic Crime Bureau finds it highly unreasonable to suggest such a proposal without a more research on the subject.

Furthermore, the Economic Crime Bureau warns about underestimating the effect on the company the knowledge of having an auditor with an obligation to report frauds may have. If the auditor no longer was to be under the obligation of reporting certain acts then perhaps companies would be less prone to listen to the advice given by the auditor therefore increasing the risk of misstatements and intentional error. As the work of the Authority is concerned with economic crime the official comment goes on to describe the development of economic crime in society. Here the development is described as more complex now than ever before, stating the relation to other organized crime in society. In working to prevent illegal acts the Economic Crime Bureau has had to develop control mechanisms and systems. The role of the auditor is in this respect very important in preventing and detecting economic crime and essential for a fully functioning control system.

## 8 Empirical findings

*In this chapter the empirical findings from the conducted interviews will be presented. The findings presented here consist of interviews which have been translated from their original language and then compiled. Together with the frame of reference and historical review presented in earlier chapters the empirical findings will later be analyzed and discussed.*

### 8.1 Interview with Dan Brännström, FAR SRS

FAR SRS stands for FAR which is the institute for the accountancy profession in Sweden and SRS which is the Swedish association of auditors. It's the professional institute for authorized public accountants, approved public accountants and other professionals that are highly qualified within the accountancy profession. They play a leading role when it comes to the development of professional standards, information as well as education within the audit profession in Sweden. They also actively contribute to the work of IFAC as well as the IASB (2010z)

Dan Brännström is the secretary-general of FAR SRS which basically means that he is in charge of the organizations operative work.

#### 8.1.1 From the audit report to the compilation report

According to Dan Brännström, FAR SRS has participated in the Inquiry about auditors and auditing and has helped their members during the whole process to prepare them for the changeover that the removal of the statutory audit means. He says that they have amongst other things, brought a new standard for accounting services. He continues by saying that the standard includes Compilation, which means that he who assists a company with establishing a financial report will confirm his participation through a special report. The Compilation service is very common in countries without the statutory audit according to Dan Brännström.

Brännström says that for now there is an extensive education going on of the country's auditors on what they call the Auditors toolbox. This education contains those services, mostly different so called confirmation assignments, that will be available next to the auditing, says Dan. He continues by saying that during the spring 2010 they will continue by informing important parties, amongst other the banks, of what the removal of the statutory audit will mean.

#### 8.1.2 Advantages and disadvantages

Brännström considers that the great advantage by the removal of the statutory audit for SMEs is that every company can have the service that they need in order to create confidence. He says that surely some companies will be able to save a couple of Swedish Crowns, but with the increased freedom

comes a greater responsibility for the company owner/board. He continues by saying that another advantage is that a removal of the statutory audit will lead to a quicker development of the services within the industry, including the auditing service. According to Brännström, a big disadvantage is the so called transaction costs, which is costs for carrying out transactions and financing, will increase. He says that we mustn't forget that we today have very low transaction costs in Sweden and this is explained by the many factors where the occurrence of auditing is a very important one.

Brännström also considers that the quality will worsen with those companies that choose not to hire professional help in the form of an accounting consultant or an auditor after the removal of the statutory audit. He says that there is also an increased risk for economic irregularities involved in this, aware as unaware. According to Brännström, a removal of the statutory audit will mostly likely lead to a negative society economic effect according to calculations made by Econ Pöyry where increased transaction costs and decreased tax incomes contributes to this.

Since small enterprises in Sweden have the possibility to form a trading company instead of a joint-stock company the companies are escaping the statutory audit in this way, where Brännström thinks that it's a good point but that the question of statutory audit has become a symbolic question that is more about ideology than real simplification or savings. Politically he says that one can of course ask himself the question of why the legislator is going to tell every company how it is going to create trust for its activities, which is what, happens through the statutory audit. He says that now they want to hand over that responsibility to the companies themselves where it is very little said about this political dimension.

### **8.1.3 The future of auditing**

Brännström thinks that initially a majority of the little companies will continue with auditing. In the future, Brännström predicts that these companies will take on more services offered by the auditor. He continues by saying that there is strong evidence that the auditor will continue to play an important role in the future of SMEs.

Brännström considers that the financial crisis has led to banks and other institutions being more anxious and cautious in taking on new clients. For this reason, SMEs that have not had their accounts audited and assured will have a hard time convincing third parties that they are solid. He thinks that the value of auditing will increase, and banks for instance will demand their clients to have audit services. Contra this stands the fact that many companies will as a result of the financial crisis save on unnecessary expenditures, perhaps even the audit fees.

Brännström states that the Swedish culture is characterized by its cautiousness. For this reason, the

decision to remove the statutory audit is likely to be delayed. However, he continues the current government has been very specific in announcing that the regulations on the statutory audit will change during their term of office.

#### **8.1.4 The expectation gap**

When speaking of the profession and the expectations of society on auditors, Brännström was of the opinion that the expectation gap would decrease if the statutory audit were to be removed. The reason for this is that the auditor will have to adjust his/her services more once the market is demand-driven in order to fit the client's needs. In doing so the client-auditor relationship could improve and so to the expectation gap.

He also thinks that the value of auditing and with that also the auditor's status will increase, since the auditing will be based on the needs for quality assurance by the parties. He states that in this also lies the essence of the auditing service being performed with great care and with a high quality since the audit must make a difference. He continues by saying that every service will be based on an agreement between the auditor and the assigner that clarifies respective parties' responsibility and role. He thinks that this will give a prerequisite for a decreased expectations gap and never more will the auditor hear that "*auditing is a necessary evil*".

## **8.2 Interview with Göran Mårtensson, Swedish Tax Agency**

The Swedish Tax Agency is a governmental authority mainly occupied with ensuring that taxation issues are fair and cost-effective. One of the primary objectives within the Agency is to develop smart routines for the collection of financial data such as the electronic tax return making it easier for companies to declare their taxes. Also, the Tax Agency has developed portal services in attempts to modernize the Agency. This has resulted in greater availability to e-services and transparency within the Agency increasing the public's confidence in the work of the Agency. A large part of their obligations and duties involves scrutinizing tax returns handed in by citizens and companies. Tax returns handed in by companies are now and have always in the past been based on material which has been supervised and approved by an independent auditor, due to the statutory audit. This in turn means that all tax returns have been based upon the same standards (2010aa).

For information on the Tax Agency concerning the removal of the statutory audit, an interview with Göran Mårtensson was conducted at the Malmö office. Mårtensson is a tax accountant for the Agency.

### **8.2.1 Detecting fraud and agency resources**

In order to handle the problem with persons engaging in economic criminal behavior, the Tax Agency relies on random sampling and certain selection processes. According to Mårtensson, some segments are more risky which is why more extensive sampling may be done in those segments. Had it been possible, Mårtensson would have liked to have more companies examined but the resources are too small for this. Once a risk segment has been identified, and the random sample has generated some samples the Agency continues by examining the auditor's report and financial declarations.

In Mårtensson's opinion the Agency's resources are sufficient given the current legislation on the statutory audit. The Agency therefore has a fair chance of fulfilling its goal in preventing and detecting economic fraud. However, if the audit function were to be removed Mårtensson is unsure of how this may affect the resources awarded to the Agency. The allocation of government resources is just that, Mårtensson emphasized, a governmental issue. Whether the Agency will require greater resources is yet uncertain, Mårtensson has not heard of any expressed opinion on the Agency's position on this subject. Personally, he suspected that in order for the Agency to operate with the same quality and efficiency, resources should be increased.

One current issue that has preoccupied the Tax Agency has to do with the standardization of forms and the availability of e-services to companies through the Agency's official website. These initiatives are a part of the Agency's long-term vision but will also be useful if the audit function is to be removed. All the simplification initiatives undertaken by the Agency are intended to help companies if they decide to take advantage of the coming proposal. By doing this the Agency will still have an overview of the incoming cases and will not have to examine each individual case. Mårtensson is of the opinion that the standardization initiatives will definitely improve the workflow within the Agency once the law comes into force.

### **8.2.2 Economic crime and cost issues for SMEs**

When discussing the occurrence of economic crime in light of the removal of the statutory audit for SMEs Mårtensson believes that more crime and irregularities will occur, both deliberate and those committed by mistake. As the auditor has a role of assuring quality, this assessment will be lost if the auditor is removed. However, Mårtensson points out that even clean audits sometimes contain errors. In any case, the auditor provides a service to the client to a certain fee. Of course, even if companies stand to save on these fees by removing the statutory audit service the question remains as to what price they will do so, Mårtensson wonders. Will the benefits actually outweigh the cost? Loan institutes and other parties may still request audits in the future and so by removing this service these SMEs will actually be doing themselves a disservice.



In addition, even if SMEs will in the future rely more on consultancy and other related services once the statutory audit is removed, these services will still be costly. This means that SMEs may be relieved of some costs but these will just be replaced by others. In conclusion, the cost savings argument therefore seems quite weak. Another issue raised by Mårtensson in relation to SME costs, has to do with the fact that companies in worst case scenarios could be fined for the irregularities in their financial statements. If they do then the total benefit of removing the auditor will be obsolete.

### **8.3 Interview with Stefan Salomonsson, Economic Crime Authority**

The Swedish Economic Crime Authority is a key resource in combating economic crime. The Authority is a centre of competence and knowledge for combating economic crime. With employees comprising of police officers, prosecutors and economic investigators the Authority works to detect and combat economic crime. Apart from identifying and analyzing economic crime trends the Authority also proposes measures in effectively combatting economic crime (2010bb).

At the office in Malmö we were able to interview Stefan Salomonsson, an economist at the Authority. His Swedish title is ekorevisor.

#### **8.3.1 Removing an existing control mechanism**

The two most important agencies and institutions working closely together with the Economic Crime Authority are the Tax Agency and bankruptcy trustee. Both these agencies are obliged to report all economic crime to the Economic Crime Authority which in the end means that they more or less decide how much work and how many cases of economic crime need to be investigated at the Economic Crime Authority.

The Tax Agency discovers economic crime and in turn the Economic Crime Authority receives the report and starts investigations on each case. In order for the Economic Crime Authority to be able to do its work the work of the preceding agencies must be carried out first. For the most part the Authority receives cases from the Tax Agency and the bankruptcy trustee, explains Salomonsson, but many tips are received from the public. The Tax Agency discovers economic crime whether or not auditor's are involved or not in the preparation of financial information, continues Salomonsson. This is because the Tax Agency discovers economic crime and irregularities when reviewing income and tax declarations.

Salomonsson believes that the basis of the decision to remove the statutory audit lies mainly in the problematic role of the auditor to both be loyal towards the client and also the obligation to report certain irregularities.

The foundation of auditors profession is based on trust within the client – auditor relationship, says Salomonsson. This make the reportings from the auditor more credible as the auditors themselves have no personal interest or gainings from the reporting itself. The reportings of economic crime from auditors are very small in comparison to the reportings from the Tax Agency for example but are still an important part of detecting economic crime. If the auditor is later removed then perhaps the number of reportings of economic crime will perhaps also diminish, concludes Salomonsson. In conclusion, Salomonsson finds that if the auditor will be removed then the number of reportings may too be reduced, however he does not feel that the overall workload of the Economic Crime Authority will either increase or decrease as the number of cases received from the other authorities is less likely to be affected.

### **8.3.2 Economic resources**

When discussing the various official comments on the SOU 2008:32 report we came into a discussion concerning economic resources. The Tax Agency for example, in their official comment, stated the need for greater economic resources for the development of the agency in adjusting to the new conditions. These resources will be needed in order to review the current internal procedures and processes in the new settings. According to Salomonsson, the needs of the Economic Crime Agency will not be different in the future. The Agency, he suspects, will not have more to do once the statutory audit is removed. Perhaps, he continues, the Agency might have less to do in the future as a reporting body, the auditor as an informer, will be excluded from the equation. The question is whether the fraudulent persons and businesses will be discovered in other contexts or whether they will be undiscovered all together. If considering the actual process from the beginning of the fiscal year until the end of the year when the annual accounts are closed there is a certain time frame where economic frauds and errors can be detected, says Salomonsson. It is in this period that the auditor may detect economic irregularities, otherwise the next phase in detection is when the accounts are already closed and the tax and income declarations and other financial statements have been compiled. If the auditor is removed then so too is the window when economic irregularities can be detected at an early stage, concludes Salomonsson.

In detecting economic crime the Tax Agency performs random sample tests. According to Salomonsson, this method may still be applied even after the reform. However, Salomonsson suspects that the number of random tests run might increase. Perhaps the Tax Agency will pay more attention to the statements sent in by companies without auditors, says Salomonsson. This all is mere speculation in Salomonsson's view but nevertheless interesting.

### **8.3.3 Assurance and economic crime**

On the issue of assurance Salomonsson fears that negligence may well increase leading to more irregularities in financial statements if those compiling these statements do not fully master the techniques and methods as required. Accounting violations can be divided into two parts, explains Salomonsson. Firstly, there are violations caused by gross negligence and secondly, those cause on purpose. Those caused intentionally are likely not to be affected by the removal of the statutory audit. The issues of negligence on the other hand can be discussed more closely. As mentioned before, Salomonsson fears that negligence may increase as persons without proper training will be compiling financial information. But, there is a chance that the simplifications in the regulations may actually result in a decrease of economic crime caused from negligence.

### **8.3.4 Savings**

One of the main reasons for removing the statutory audit is, apart from the need to simplify regulations on smaller companies, the amount expected to be saved. Salomonsson is sceptic to the actual figure stated in the SOU2008:32 report. He comments that setting such a figure is difficult to determine. However, those that stand to gain from the removal of the statutory audit are the newly established smaller companies that may by saving in on auditing costs, be able to employ more people.

### **8.3.5 Threshold values**

When asked to comment on the various threshold values proposed in the SOU2008:32, Salomonsson felt that this matter did not really matter to him as he views the issue as a matter of principals rather than facts. The question he is interested in is whether the statutory audit should be removed or not. The auditor plays an important role in detecting economic crime and therefore removing the auditor will mean removing a control mechanism in the detection chain, without introducing other control mechanisms. This, Salomonsson concludes, will mean an opening for more criminal activity within listed companies and it most likely the fraudulent companies which will chose to remove their audits.

## **8.4 Interview with Göran Kjellén, IFAC SMP**

The Small and Medium Practices (SMPs) Committee is hosted by IFAC, the international standard setter in auditing and assurance, and represents the interests of professional accountants operating in small- and medium- sized practices and other professional accountants who provide services to small- and medium-sized enterprises. This Committee develops papers on topics of global concern and provides input in the development of international standards (2010cc). The main objectives for the SMP Committee are to work to ensure that all standard-setting bodies are aware of and give due

consideration to relevant SMP issues. Also together with other IFAC boards the SMP Committee works to support SMEs providing them with accounting and assurance services by leveraging the work of member bodies and others. In order to develop guidelines and help SMEs the Committee also seeks to identify relevant issues concerning accounting and assurance services as well as providing practical support to SMPs (2010dd). Göran Kjellén works as a technical adviser for the IFAC SMP Committee.

#### **8.4.1 IFAC and the removal of the statutory audit**

As a member of the SMP Committee Göran Kjellén is very familiar with the work IFAC does to support SMPs in the reform process. We asked Kjellén to explain how IFAC has been working in preparation for the removal of the statutory audit in Sweden. According to Kjellén the current IFAC president, Robert Bunting, is very considerate of the fact that 95 percent of the world's companies are SMEs employing two-thirds of the global workforce. By emphasizing the needs of SMEs, Bunting has raised awareness of the current situation.

Furthermore, IFAC is currently undergoing a wide reform regarding how to better provide adequate services and support to SMEs through its member organizations. The SMP Committee has also for the last 10 years focused on the interests of smaller companies meaning these companies and their auditors have been attended to as a first priority.

Kjellén continues on by describing the SMP Committees work with its member organizations which mostly consists of supervision and coaching in different matters varying from the implementation of ISAs to guidelines on how to handle quality control issues. One area that has been less successful is spreading awareness on the online services available through the Committee. When discussing the removal of the statutory audit in Sweden and in the other Scandinavian countries Kjellén recounts the obstacles in terms of international harmonization and global standards. The statutory audit in the US applies only to major businesses. In the EU most of the countries have chosen to adopt the EU's minimum requirements as their threshold value. In light of the harmonization process now Sweden has to decide on a threshold value too. The difference is that the Nordic SMP representatives have pushed hard for a revision of the current standards concerning alternative services, one might call this initiative a sort of demand for modernization in the current standards. The results of these efforts can be viewed in ISRE 2400 and ISRE 4410, says Kjellén.

The complexity of the matter is at times overwhelming, continues Kjellén and refers to ISAE 3402 as an example. From a Swedish perspective these standards can sometimes seem quite narrow and maybe hard to understand.

The SMP Committee also works on giving feedback on different aspects on all standards during the many phases embedded in the construction of a standard. This is very instructive and interesting, says Kjellén, though at times also very strenuous and a great workload for those working voluntarily for the Committee. The transparency within IFAC is truly exemplary concludes Kjellén after discussing the efforts and work put in by all IFAC members.

#### **8.4.2 The future of auditing**

The current role of the auditor is besides other things to advise his client on legal boundaries, explaining what is expected and required from the client in different matters. Those companies that then chose to exceed the legal boundaries are in Kjellén's opinion well familiar with the regulations but choose not to abide by these and further ignore the advise given to them by their auditors. These companies are most likely looking for an auditor to give them a clean audit with an unqualified opinion. Once the auditor is in place and familiar with the company such an opinion is unlikely to be stated thus complicating matters for the company. Finding a professional and competent auditor to give an unqualified opinion when the reality of the matter is otherwise is not an easy task. The professionalism and competence of the auditor is very central to the future role of the auditor.

Those companies who on the other hand follow the legal regulations and have no intention on pushing the legal boundaries may in the future rely on a lower assurance level as they are not in any risk zone of committing economic crime.

The foundation of professional auditing is that the auditor is truly familiar with his or her client. Kjellén discusses that auditing that isn't based on several years of experience with the client company and management entails a higher risk than otherwise. The same goes for audits performed by auditors relying on checklists where the signing auditor has little knowledge of the actual audit but still relies on the statements compiled by unexperienced assistants. The key issue that Kjellén points out is that auditing requires both a commitment and intellectual consideration from the auditor.

With the removal of the statutory audit one must consider the role of the auditor in the future. Kjellén believes that the role of the auditor will definitely not diminish even though the statutory audit will be removed. The auditor is currently one of the key persons and advisors for many companies and will therefore still be needed in the future. In the end, Kjellén continues, it comes down to competence, the knowledge embedded in the auditor that differentiate the auditor from other less qualified. Removing the statutory audit does not change this fact.

Opinions given on lower assurance levels, such as the review, will in the future become more common according to Kjellén. The reason for this being for instance that the users of the assurance report will be satisfied with the level of assurance it represents if this is done in accordance with international reporting standards. Furthermore, Kjellén expects the current independency requirement probably to be reduced which may be a contributing factor to the future spread of the review.

When it comes to compilation reports, Kjellén expects this to become the most commonly used reporting method in the future with reference to both the US and European development. In both these cases where the statutory audit is defined for a very small part, around 5 percent, of the market compilation reports make up 80 percent of the reporting methods whereas reviews stand for around 15 percent. Perhaps this says something about what is to be expected in Sweden.

### **8.4.3 Demand driven auditing**

When giving his opinion on the advantages of a demand-driven auditing profession, Kjellén first discussed the idea of the free market stating that each type of free market is rational and most ideal. Firstly the primary users that will be benefitted are the owners of the company whom after the reform will be free to chose what types of services they will require including attestations and confirmatory opinions related to quality assurance. Also as audit firms have been working to adjust to the expected changes these will be well prepared when the time comes. Furthermore Kjellén believes that external users of the company's financial information will be more involved and active in influencing the company's owner or management when deciding on what levels of assurance and advisory services to rely on. According to Kjellén, studies in the UK have shown that credit institutes and banks are more likely to be positively inclined towards financial statements compiled by a qualified professional than otherwise. This may well be the case in Sweden too as credit-rating agencies are very much dependent on the correct reporting of financial information.

The greatest advantage however may well be that assurance will be given at different levels depending on the clients needs. More consideration will be taken to the needs of small companies who no longer will have to abide under the regulations set for major ones. This principal is irrational and very costly for smaller companies. The benefit really does not weigh up for the cost for the smallest companies is the overall message. The well-known mantra “an audit is an audit” is wide-spread in the accountancy profession but should be applied to a somewhat homogeneous mass of similar companies if it is to have any substance, says Kjellén.

#### **8.4.4 The future of the auditor**

Auditing is the methodology applied to establish a platform or basis for an opinion or confirmation given by the auditor, explains Kjellén. Furthermore, the auditor for these reasons has to hold a certain level of competence and professionalism to perform the audit. Once the statutory audit is removed the number of auditors will definitely be reduced, continues Kjellén. According to Kjellén the role of the auditor will strictly become more of a specialist function being addressed to perhaps 30 000 to 40 000 companies whereas in the current situation the number of companies being audited is about 300 000.

When it comes to the actual role of the auditor in foreign countries after the removal of the statutory audit, Kjellén discusses the branch development he himself has witnessed in Australia where the auditor has surpassed into other roles. This development from strictly auditing towards more advisory and financial consulting services may suit certain auditors but far from all auditors possess the competence required in these services, explains Kjellén carefully. The issue Kjellén continues, is that even though auditors are professionals they may have difficulties in embarking on unfamiliar territories and should therefore refrain from doing so.

In Denmark though the auditor has now become known as “*den nära rådgivaren*”, meaning the close advisor according to Kjellén. The foundation of a successful and meaningful relationship between client and auditor is based on the auditors understanding of the clients needs and knowledge of the clients business. With this said Kjellén believes that the question of auditor independence can be problematic but with the right level of ambition and professionalism as well as with the backing of a professional society, the independence and integrity of auditor does not have to be jeopardized.

#### **8.4.5 Expectation gap**

When asked how the removal of the statutory audit would affect the expectation gap Kjellén answered that it definitely would contribute in decreasing the gap. The expectation gap is essentially an issue related to quality if one defines quality as the level of achievement with regard to client expectations. If the right expectation are placed and then mirrored then the expectations gap will decrease. With this argument Kjellén concludes that demand driven services will indeed decrease the expectation gap if the expectations and services provided are clearly clarified beforehand. This goes without saying that if these are not clarified and instead are poorly defined then risk of discontentment with the services provided will increase, thus increasing the expectation gap.

#### **8.4.6 Economic crime**

Kjellén is of the opinion that the occurrence of economic crime does not correlate to economic conjunctures when asked about the risk of economic crime in times of recessions and if removing the

statutory audit in these times may be a contributing factor to the occurrence of economic crime. Kjellén points out the possibility of economic crime rising in times of economic growth and prosperity. This perhaps because of lower safeguards and a lower level of caution in society when all is problem free. It seems more likely that economic failures are receive more exposure in less prosperous times even though the occurrence of economic crime may not be correlated to economic conjunctures. What we have seen during this recessions, Kjellén concludes, is that there have actually been less bankruptcies than expected signaling that perhaps the occurrence of bankruptcies may be affected by other factors such as new strategies from the banking sector.

In Kjellén's experience the root of economic crime derives from a resistance to comply with regulations in society's and the especially the business and commercial world. Unscrupulous persons lacking the intention of following regulations may often engage in smash and grabs with shell companies allowing them to shortcut to economic profit.

The occurrence of economic crime is a phenomenon that exists in all societies, says Kjellén, varying from very organized structures dealing with narcotics and trafficking people to lighter forms such as tax fraud, the latter being a part of everyday life for an auditor. The auditor has an important function in dealing with these matters, as they have an obligation to make their clients aware of the errors in their books and reporting giving them the chance to rectify the errors.

#### **8.4.7 Comparisons with foreign countries**

When comparing Sweden to foreign countries with regard to their development in issues related to the removal of the statutory audit Kjellén recalls that the Danish market of auditing services decreased with about 40 percent due to the reform. The danish tradition of auditing listed companies is, according to Kjellén, stronger than in Sweden. Also, the issues concerning conflict of interest have been less strict in Denmark which may explain why SMEs have continued to appoint auditors in audits. With this in mind, the development in Sweden may lead to a greater loss of audits in the SME sector.

An issue currently being examined in Denmark concerns the introduction of a mandatory service lying somewhere in between the audit and the review once the threshold is raised. This issue is expected to result in a political decision during the first quarter of 2010. Kjellén considers the development in Denmark to be unfortunate from an international harmonization and standardization perspective. However it is understandable, he says recalling that there already are a few hybrid services on the international review standard ISRE 2400 in Germany, Switzerland and France.



## **8.5 Interview with Christofer Hultén, Grant Thornton**

Grant Thornton is one of Sweden's largest accounting and consulting firms providing services mainly to owner led companies more commonly referred to as privately held businesses (2010ee) . As Grant Thornton's client will be affected by the removal of the statutory audit we decided to interview the head of the office in Malmö, Christofer Hultén in order to gain perspective from an auditing firm and auditor. Apart from being the head of the Malmö office, Christofer Hultén is also a certified public accountant and partner of the Grant Thornton organization.

### **8.5.1 Current duties and the auditing profession**

Historically it can be said that this line of business in general has had a poor dialogue with the public and especially with its customers. Therefore there are still customers who don't know the difference between an audit and accounting, Hultén explains. When examining international audit firms with regards to the removal of the statutory audit, we can see that they haven't lost a great deal of their customers which one might have expected. In fact, Hultén sees no need for future worry as only a small portion of the clients, among the SME:s, who had previously engaged auditors were inclined to deny future assistance. Grant Thornton is therefore fairly certain that some companies will choose to except external auditing, which isn't wrong for either part depending of course on the structure and size of the specific company.

Hultén goes on to exemplify this trail of thought with an example. For example, he says, a company run by one person, with few or no employees, no loans and are self financed, is probably not in need of an auditor because there are no stakeholders to satisfy. No loan givers, banks or shareholders that demand to have a look at the financial statements. In their cases the audit provided by us is relatively expensive. The tax agency is however one stakeholder who always would like an adequate audit performed by an independent auditor. They will probably, when the law passes, have to work harder, recruit more personnel, which will cost the society and the tax payers a considerable amount of money.

The aim of Grant Thornton is to work towards the customers. According to Hultén, Grant Thornton haven't been able, to express what it can do for the customers in the past to the extent hoped for. This reform may therefore help clients see new dimensions of their businesses, and may therefore require help in other regions than before. The clients will in many regards be dependent on our expertise and our know-how, states Hultén. Audit firms will be able to help customers with a wide range of tasks which will be of considerable assistance for many companies, even small and medium entities. New strategies have already been formed and in some ways implemented. The market oriented approach has

begun. We can no longer wait for customers within the SME segment to turn to us for assistance, Hultén concludes. About 80% of Grant Thornton's clients will be affected by the new law. Therefore the firm has to become even more proactive, which actually makes the daily work of the auditor more fun and interesting, Hultén states. We will also work more as consultants than we have before. How potential customers will act when the law finally passes is also, I think, in the hands of each audit firm. Depending on how we as a company can sell in different services to small and medium sized companies might be the difference between success and failure. So in these aspects our current duties will be slightly distorted in the future, says Hultén.

### **8.5.2 SMEs and potential benefits of the reform**

According to Hultén only a few companies will actually benefit from a removal of the statutory audit of SME:s. There will still be a great need for assurance for the larger part of all SME:s. As mentioned earlier, stakeholders will not be any less inclined to examine the financial statements. Assurance is important for all parties, both internal and external. Especially in a recession it's even more important to run an open and transparent company. If a bank loan is required it's very important that an external independent party can assure those who might be willing to give them the loan. How else will the creditor be able to estimate the clients ability to repay this loan, questions Hultén.

It has been said that the removal of the statutory audit for SME:s will be more cost efficient for the companies involved, and that the society as a whole can save money. This statement is not accurate concludes Hultén. He personally cannot see signs of this at all. When looking internationally the removal hasn't been beneficial for many companies. Hultén explains that there aren't virtually any companies that have been able to save money due to the removal of the audit. Therefore Hultén believes that the removal will not make a significant impact on the Swedish industry, nor on society in general.

### **8.5.3 Alternative methods**

When discussing alternative methods of providing assurance Hultén believes that it might be sufficient to provide lesser assurances and audits if it suites the stakeholders. If a company, for example, has a large stock in trade Grant Thornton as a as external auditors can be engaged by clients to go in and assure stakeholders of its content, continues Hultén. This might in many cases be sufficient to some stakeholders. Their criteria of a correctly estimated stock in trade has been met, and they are now willing to give the company the requested loan. In the end Hultén believes that the decision essentially falls upon the stakeholders to decide what level of assurance in fact is sufficient and satisfactory.

One method discussed by Hultén was the compilation report, where an audit consultant can sign off that they have aided in drawing up this financial statement. The concept of the compilation report has sometimes been misunderstood by both clients and stakeholders. The report is not, as some believe, an assurance of the contents of the closing of the books. It's actually more of a compilation of the closing of the books. The compilation report, which is used today even when forming agreements, might be even more utilized in the future. Hultén believes that there are ways of exercising adequate assessments of different types of businesses and companies where the companies can choose from a wide range of more or less reliable assurances, all depending on the request of the third parties, the stakeholders. With this in mind all companies do not need to perform a full audit. If stakeholders know what they would like to examine to become satisfied, a full audit is redundant. It will probably not be cheaper for customers in the future. Every engagement will be more likely be based on the needs and demands of the customer.

#### **8.5.4 Economic crime**

On the subject of economic crime Hultén believes there is a risk that economic crime will increase when the statutory audit for SMEs will be removed. Audit firms have otherwise always been an obstacle to overcome for those who knowingly and unknowingly have made errors in their financial statements. The amount of real criminals who commit fraud will probably not change, they have always resorted to economic crime, Hultén explain. When no one is obligated to annually audit the company some entrepreneurs might take their own liberties, Hultén continues. He concludes that the audit firms, during their annual audit see a lot of things that have to be changed or specified.

Therefore, he says, without our audit the Tax Agencies will have their hands full if they want to have a reasonable chance of detecting errors. The Tax Agencies will have to increase their resources which will cost the society more. In conclusion Hultén expresses that he doesn't really see who will gain from the new legislation.

#### **8.5.5 The recession and audit**

Some companies might be tempted to decline an audit in a recession because of the money that can be saved, Hultén discusses. This course of action, he states would be a mistake. If you find yourself in a position when you are in great need of financial aid, which is fairly common for many companies during a recession, you probably would have an easier time persuading loan givers of granting you that loan if an audit had been performed, explains Hultén. Assurance is always needed and probably even more so during a recession. So saving money by declining the audit, Hultén feels, is a short term action which will not benefit firms in the long term. Also, if many companies choose to not perform an audit what will then happen, Hultén asks.

## 9 Analysis and discussion

*The following chapter contains an analysis of the previously presented information.*

*Here the theoretical framework and the empirical findings will be interpreted and discussed in three main sections.*

### 9.1 The audit profession in general

An auditor is responsible for ensuring a proper financial reporting, where ensuring transparency, assessing liability and maintaining credibility are the key factors. The society demands different things and as the society changes, so does the demands made on the auditor. The most important issue however is that the work of the auditor has to reflect what the society considers to be trustworthy information and their need of such information. For 50 years ago the auditor mainly worked as a tool in preventing and detecting fraud in the companies. Nowadays we consider the auditor as a tool for giving a verification of truth and fairness of the financial statements. There has been a radical shift in the expectations from the society. The key expectations from the society on the auditor are that the auditor should give an assurance on the fairness of the financial statements, give an opinion on the company's ability to continue as a going concern, look at the company's internal control system and the occurrence of fraud and illegal acts.

With the removal of the statutory audit for SMEs we consider that the need for proper financial statements will increase and perhaps even change the auditors role to as it was 50 years ago. Once 96% of the companies in Sweden no longer have to have an auditor, the work will be done by the companies themselves if they choose not to hire an auditor. This could mean that the possibility of increased errors in the financial statements will occur. Once this happens then the auditor will automatically shift to the role of preventing and detecting fraud in the companies. Once an auditor is not present in a company, then who is going to give a true and fair view of the financial statements? The owner, who has a personal gain the company, the bookkeeper, who is not willing to admit his mistakes and perhaps his lack of experience, the board of directors, who are mainly interested in the company's well-being and a high profit? It will be very difficult to find an independent person who can give the society what it demands. The expectation gap might in this case increase once the removal of the statutory audit for SMEs takes place.

In a study conducted by FAR SRS, credit managers expressed a concern facing the market changes. They ultimately had a negative attitude towards the removal of the statutory audit for SMEs mainly because they are concerned of the uncertainties in the future. On the other hand, many companies are

outsourcing their administrative work. The companies might possibly handle their own bookkeeping so one can say that they are very dependent on the auditor and his/her services. This lets us believe that it will most likely lead to the companies choosing to continue to have an auditor.

In the UK and in Denmark for example, companies generally chose to keep the auditors services even when the removal of the statutory audit for SMEs was in place. This gives us an indication of how important an auditors services really are, and even if there is no obligation to have an auditor for SMEs they still serve an important role in a company. In the UK the board of directors found that an independent auditor most certainly increases the quality and credibility given in the financial reports. This tells us that the auditor is still having the role of an assurer, at least when third parties are involved such as banks and credit institutes. These users still demand a certain level of assurance despite what the companies consider to be necessary.

### **9.1.1 Negative effect on the audit profession**

If we look at the negative aspects on the audit profession once the removal of the statutory audit for SMEs was introduced in Denmark, it turns out that there has not been a significant impact in the audit profession. Of course they think that this might change over the next couple of years, probably due to the fact that change takes time and that the consequences appear first after a couple of years has past. Some investigations that have been made regarding the change in the audit profession once the removal of the statutory audit for SMEs came in place in Denmark, point to the fact that as many as 70% of the smaller companies will choose to have an auditor whilst other investigations say that merely 50% will choose to keep the auditor. These are of course only predictions of the future.

One benefit of the removal of statutory audit for SMEs is the fact that there will be an increased opportunity for an audit office to work with accounting issues and offer smaller companies a package of cheaper and easier access to competence. The auditor independence must however be in mind at all time. This will work as a way to increase the inclination to have an auditor for smaller companies. The price has always been rather high on audit services, and package deals are always appreciated.

As mentioned before, the demands of an auditor changes and with the removal of the statutory audit for SMEs, auditors will have to come up with other ways, besides the package deals, in order to attract clients. Once the need for guidance comes from the removal as well as the importance of the customer benefit comes in place, the auditor will need a change in the services offered. This lets us believe that competence development in areas such as communication and sales will occur.

### 9.1.2 The auditors and service fees

In Sweden, the number of auditors has decreased over the past decades. In the long run, it is believed that the removal of statutory audit for SMEs will lead to an even more decrease in the audit profession. Since this decrease is beginning to show now, it's a bit worrying since this proves that the reform suggestions are powerful and its impact way greater than expected. If this continues to go on, then how will the audit profession develop? Will there be auditors in the next 100 years, or will they be taken over by consultants.

In the study by Jørgensen and Stensjö it was concluded that educational needs in areas such as tax, accounting and auditing are needed as well as within areas such as sales techniques, marketing and presentation techniques. The change will bring a demand oriented market into place where the monopoly that existed before within auditing, will be replaced with services actually needed and demanded by the companies. They will be able to choose from a range of consultants, auditors, accountants, etc. The limitation before to strictly have an auditor will no longer be. Before the companies were not able to decide themselves what kind of audit services they required. They were given a set of services for a certain price. With the reform they will be able to actually decide for themselves exactly what their company needs and requires. This could help in decreasing the expectation gap since the expectations of an auditor and the work performed by the auditor may converge.

A positive effect for the companies is that the fee will most likely decrease. Accounting offices have lower prices and the auditors from smaller audit firms and perhaps even larger firms will have to compete with lower prices on the market. This in turn is a bit alarming for the auditors for many reasons, where one is the fact that they have to compete on the market for their services and another that they have to cut down their prices. We think that this might jeopardize the entire audit profession itself. In order to become an authorized auditor in Sweden, you have to have a 4 year education at university level followed by 5 years of practice. After this the candidate must pass an examination from the Board of Auditors in order to be able to work as an authorized auditor. For an approved auditor, the practice is 3 years, everything else is the same. For accounting services it's not as complicated. Once the prices between these two will be similar or even the same, then what is the point of going through the extensive education and practice that is required in order to be an auditor, especially when some don't even know the difference between an auditor and an accounting consultant.

Due to the increased competition between auditors and consultants, it's most likely that many auditing firms and accounting firms will join forces in order to be able to achieve a cost advantage. This can be negative in the sense that we today have big auditing firms. If these join forces with other smaller auditing firms, or accounting firms, then what happens to the prices on the market? They will most likely increase to a certain level that the big companies can accept leading us to the condition that we have today where the prices are not market decided. With the removal of the statutory audit for SMEs this will most likely increase the confusion amongst the public.

On the other hand, the decrease in the prices will lead to an international advantage for the companies. Foreign companies in other countries don't have to face the extra costs for auditing that the Swedish companies do, giving them a cost advantage. With the removal of the statutory audit for SMEs, Swedish companies might be able to compete on the same terms on the market.

### **9.1.3 The financial crisis and demand for audits**

As we currently are in a financial crisis the need for quality in financial statements is high. In this time we doubt that there will be anyone prepared to give up their auditor. Banks, shareholders, and other key user groups, have high demands on a company's financial statements in these times leading us to believe that auditors will have work for the next couple of years at least.

Even with the removal of statutory audit for SMEs, key user groups can still demand from a company to have an auditor. Banks, suppliers, etc. might give that ultimatum in order to assure themselves, especially in this time with the financial crisis.

The audit profession, as mentioned before, has seen many changes. What we now can expect is one of the following: some will continue doing what they do now as an auditor, others will aim at offering voluntary auditing for smaller companies, some will offer reviews and compilations, some will instead specialize in offering tax counseling or risk management and finance, others will turn to economic departments in various companies.

	Tax Agency	FAR SRS	IFAC SMP	Grant Thornton	Economic Crime Authority
PROS: removal of the statutory audit for SME:s with regards to the audit profession in general		<p>Value of auditing increase since the needs for quality assurance will be by the parties</p> <p>Support the proposals in SOU 2008:32</p> <p>Companies buy broader range of auditors services</p> <p>Expectation gap decrease because an auditor performs services adjusted to every company's situation and need</p> <p>Majority of small companies will continue auditing</p>	<p>An auditor is one of the key persons and advisors for many companies and will still be needed in the future</p> <p>Competence and knowledge embedded in an auditor differentiates them from other less qualified. The removal doesn't change that</p> <p>Companies are free to choose services they want and need</p> <p>Banks will be more inclined towards financial statements compiled by a qualified professional</p> <p>Expectations gap will decrease &gt; more demand driven services</p>	<p>Audit firms will be able to help customers with a wider range of tasks</p> <p>The services provided to clients may well be more stimulating for employees at audit firms.</p> <p>Audit firms will have to more proactive once law is passed &gt; more interesting and diversified work</p> <p>The profession will see more consultancy services in the future demanding more from the auditors which is a positive pressure</p>	<p>A matter of principles &gt; EU harmonization and progress for the profession in general but not for the work of the Authority</p>
CONS: removal of the statutory audit for SME:s with regards to the audit profession in general	<p>Agency does not support the proposals in SOU 2008:32</p> <p>Change in services performed &gt; government should set specific requirements and demand certain qualifications for those in the market for consulting services</p> <p>Auditors have a role in assuring quality which will be lost if the auditor is removed. SMEs will rely on consultancy but even these are costly.</p>	<p>Extensive education in services that will be available next to auditing</p> <p>Quality of financial statement will worsen when there is no auditor</p>	<p>Number of auditors will be reduced</p> <p>Auditing will become a specialist function</p> <p>More advisory and financial consulting services than auditing</p>	<p><b>More consultants than auditors, lesser demand for auditors which puts pressure on the profession to adapt</b></p> <p>Reduced need for auditors in general</p>	<p>Authority does not support the proposals in SOU 2008:32</p> <p>Loss of auditor and statutory audit means removing a well-embedded control mechanism &gt; loss in quality and confidence of financial statements</p>

The table above represents what the our interviewees think of the removal of the statutory audit for SMEs and its effect on the profession in general, we can see that the most common concerns with the removal of the statutory audit for SMEs deal with quality-related issues. The respondents are worried that the quality will worsen in the financial statements provided by the companies as well as that there will be a greater range of consultants on the market than auditors. This will ultimately turn the auditing function to a specialist function commonly used by the companies leading us to the conclusion that the number of auditors will most likely be reduced.



There will ultimately be more advisory and consulting services on the market than a clear audit which will require more education in these services. As Brännström from FAR/SRS said:

*“There will be a need to develop the auditor’s toolbox with the services that will be available next to the auditing”.*

The Tax Agency in Sweden is totally against the proposal but comments that if the removal of the statutory audit for SMEs takes place, there will be a change in the services performed which they think that the government should take a look at and set specific requirements and demand certain qualifications for those in the market for consulting services. This will of course lead to extra costs for the society and perhaps the cost savings from the proposal will disappear.

On the other hand, the value of auditing will probably increase since the need for quality assurance will come from the parties themselves, which will ultimately decrease the expectations gap since the auditor will perform services that are adjusted to every company’s situation and need. Despite the many worries the removal of the statutory audit for SMEs has brought, it’s still believed that the majority of small companies will continue to have audits. An auditor is still considered as one of the key persons and advisors a company can have and this is something that is going to be needed even in the future. The competence and knowledge that is embedded in an auditor is something that differentiates an auditor from other less qualified practitioners. The removal will most certainly not change that leading us to believe that the essential meaning of the word auditor and what he/she stands for will still be needed and appreciated in the future.

There will always be a great concern from the company’s perspective regarding whether or not they will be able to continue as a going concern. The auditor is the most qualified one to give that opinion, and we believe that there won’t be a huge decrease in the number of companies choosing an auditor. At least not in the foreseeable future. There will on the other hand be a greater range of services offered on the side of the audit itself, which we consider only to be positive since the society will be able to choose what it wants and needs. The auditors work has always been complex for an uninformed person, but with the removal of the statutory audit for SMEs will come a greater insight in the work auditors perform and this will ultimately lead to a better understanding of the society’s perceptions of the audit profession in general.

## 9.2 Quality and assurance

The range between a clean audit and a compilation report is very wide if you read the definitions, although, one might add, that the definitions are pretty vague in their description. A clean audit, which can be read in Iwasaki, is drawn up by an auditor who, after careful consideration, believes he or she has obtained reasonable assurance about the financial statements and internal control systems. The compilation report, on the other hand, is drawn up by an auditor with the purpose of compiling information for the client. The information is neither obtained nor examined by the auditor, only compressed by the auditor. But the compilation has become, according to Dan Brännström, relatively common, if compared with Sweden, in large parts of Europe in countries which have removed the statutory audit for small sized companies.

It must be said that none of the above mentioned reports will guarantee that the report presented by an auditor is free from material misstatements or fraud, nor can the auditor be absolutely certain that no illegal acts have occurred during the time period which is examined.

Which leads us to the understanding of the stakeholders. In interviews made with Hultén of Grant Thornton and Salomonson from EBM, both interviewees felt inclined to doubt the stakeholders ability to, in many cases, get an understanding about the financial statements when presented to them. This was said about shareholders, loan givers as well as governmental stakeholders. This unfortunate situation, with incomprehensible financial information which may or may not have been thoroughly audited by an external independent party could lead to a decline in the quality and assurance of the financial reports which are presented to different stakeholders.

Hultén of Grant Thornton stated that:

*It is not only the third party stakeholders who in some cases have had less than sufficient experience with audits and alternative methods. The business executives, especially in small and medium sized companies, also fail to understand the different level of assurance between a clean audit and a compilation report.*

The ISA clarifying project has acknowledged this problem and their ambitions to make the audit more understandable will hopefully make a positive impact in the audit community. The constant focus on simplifying regulations and producing official guidelines especially for SMEs is a way of tackling this problem.

### 9.2.1 Assurance, quality and the expectation gap

The expectation gap studies, which is presented in Hayes et al, shows that the general users, which includes stakeholders as well as business executives and employees, already have a different view and expectations on the auditors ability to examine and determine whether a company is run in a sufficient and respectable manner. To summarize, the general public are in all aspects but one are inclined to believe that the auditors obligations are far greater than they are in reality. Which shows that expectations exceed the auditors actual duties.

Therefore, we ask ourselves, what will happen when the statutory audit of SMEs is removed? There is a probability that the expectation gap will be even greater in the future if the removal of the audit is not widely acknowledged and understood by all parties subjected to the change. In respect to this Hultén says that their business approach will be different in the future. They as an audit firm will, added to their usual services, also have to be more customer oriented and educational. Instead of just receiving customers, their approach has to be more market oriented and they will probably enlist more clients who would like tailor made solutions that fit their conduct of business. As pointed out by Hultén and Kjellén, a company run by a single person with no employees, self financed and no requirements for bank loans is in no need of reliable audits made for the sake of the stakeholders. This kind of entrepreneurs with these or similar conditions does not need to satisfy third parties and would therefore do well in considering the possibility to decline an audit engagement. With this possibility to decline the audit engagement this service is subjected to the free market, which Kjellén describes as rational and most ideal. The audit becomes demand driven, even though some companies in reality can not afford not to conduct a full scale audit, due to third parties, mainly shareholders and creditors. Furthermore, Kjellén also says that a new paradigm might occur where third parties will get more involved in the decisions made by management, when it comes to decisions related to which level of assurance is needed to get an adequate view of a company's condition. As well as there are different types of companies who are in need of different levels of assurance, the audit firms now also have begun expanding their selection of services which could mean, according to Hultén, that the audit firm engagements will grow in the years to come. Although revenues per engagement in the future might be lower since a full scale audit is more costly to clients than other less reliable assurances, and therefore less in demand.

The independence of an auditor is critical when users of an audit want to ensure quality and gain assurance of a company's financial statements. The effects on how auditors independence will be affected by the removal of the statutory audit for SMEs is therefore also something that has to be

taken in to consideration when we evaluate the standards of quality and assurance when submitted to a seemingly less formal control procedure. Something that should be taken in to consideration; In the worst of worlds a free market could mean an increase in the pursuit of clients, and it will become a client driven market where the auditor's independence might be impaired at the cost of the auditor profession in general.

### **9.3 Economic crime**

Trust and confidence are essential in matters dealing with financial statements and services for the public. Essentially, the audit service deals with providing a service to interested parties ranging from shareholders to less apparent stakeholders. The audit has therefore traditionally been viewed as a assurance providing service. This has applied to all limited firms obliged under the statutory audit. With the removal of the obligation SMEs will be given the opportunity to be exempted from the audit and may instead rely on other engagements.

When relating this to the occurrence of economic crime and fraudulent behavior certain factors must be addressed. Firstly, as was assumed and then confirmed by our interviewees there are two basic types of behaviors which can be discerned – those who engage in fraudulent behavior and those who don't. Those inclined to engage in dishonest business are typically those who have a great understanding of the regulatory system and believe they know their way around it. These persons will according to our interviewees engage in dishonest behavior whether there is an auditor present or not. These cases are ultimately detected by the auditor or later on by the Tax Agency and then reported to the Economic Crime Authority for further investigation. And then of course there is the category which represents those engaging in dishonest behavior by accidental fault. In any case, our interviewees have denounced the importance of the auditor as the audit activity is considered to have a preventive effect on the occurrence of economic crime. Once the statutory audit is lifted the preventive effect too is removed and may therefore lead to an increase in irregularities in the financial statements of a company. It is for this reason that our respondents have expressed concern about the loss of the auditor as a part of the control mechanism function.

Understanding the complexity of economic crime has never been the issue in this thesis, however we have been interested in understanding the occurrence of economic crime in SMEs. Do perhaps SMEs have greater och less reason to commit economic fraud? Perhaps SMEs have suffered the effects of the recession to a larger extent than larger companies and may be more prone to tamper with their financial statements.

In 2005 Thorell and Norberg stated that if SMEs were to be exempted from the statutory audit then the risk of economic crime within these companies would rise. We also wonder if the current recession may influence this fact. But according to Göran Kjellén from the IFAC SMP Committee economic crime does not correlate to conjunctures, if anything Kjellén is of the opinion that economic crime could rise in times of prosperity. This because fraudulent companies may take advantage of societies reduced control mechanisms during financial booms.

Despite each respondents different professional background and current professional position, all expressed concern about the loss of the auditor when discussing economic crime. As the auditor, reports and works to ensure fair and correct financial statements all interviewees at least questioned who would take over the auditors role. Either it being less qualified accounting consultants or perhaps the Tax Agency in detecting fraud, this question still remains unanswered.

Surprisingly, the Tax Agency does not expect to change their current work processes and procedures in detecting fraud, at least not at once. This was interesting as our other interviewees all expected the Tax Agency to be very affected by the proposition, at least in terms of detecting economic crime. The Tax Agency on the other hand is state-controlled and cannot make it's own decisions regarding resource allocation. All changes to the work of the Tax Agency will therefore come from government at a later stage.

The foundation of the abolishment lies in the opinion that SMEs should not have to be burdened by unnecessary administrative costs. The removal of the statutory audit is an initiative taken to stimulate the economy and facilitate the growth of SMEs. The government letter (1994/95:21) concludes that the auditor is an important resource in preventing economic crime, as the auditor has good insight in the business of his/her clients. By removing this insight, the preventive effect of the auditor is removed as well. However as pointed out by Salomonsson at the Economic Crime Authority only a very small number of cases of economic crime are actually reported by the auditors themselves. Removing the auditor through this perspective will not actually affect the number of cases reported, instead as mentioned before it may be difficult to estimate how strong the preventive effect has been on SMEs.

Another aspect that also may influence the occurrence of economic crime are the thresholds that are yet to be selected by the government. If the thresholds are set to a higher level, more SMEs will be exempted from the audit. The positive side of this is that this may stimulate the economy and help SMEs run their businesses more efficiently. On the other hand, once the auditor is removed a control

mechanism will be lost which may increase the occurrence of economic crime. And if the thresholds are set a too high a level the occurrence of economic crime may be even greater. The challenge of setting the right threshold value is acknowledged in the current debate and should be examined further before changing the current legislation.

## 10 Conclusions

*In this chapter we return to the underlying research questions presented in the introductory chapter and answer them accordingly.*

### 10.1 On the profession in general

#### **What can be expected of the effects on the removal of the statutory audit for SMEs regarding the audit profession in general?**

An auditor is nowadays considered to be a tool for giving a verification of truth and fairness of the financial statements. With the removal of the statutory audit for SME:s where the companies will be able to handle their own bookkeeping and not have to hire an auditor, the possibility of increased errors in the financial statements will most likely occur. With the financial crisis we are in now, the need for proper financial statements will most likely increase especially when banks and other loan institutes will be more inclined to demand an audit from the companies.

An auditor is considered to be a key person and advisor for many companies and will still be needed in the future, with their competence and knowledge that differentiates them from other less qualified persons. The removal of the statutory audit for SME:s will not change this fact. There will on the other hand be a wide range of tasks available for the companies to choose from leading to a decrease in the expectations gap since the companies will be free to choose what services they want and need leading it to be a more demand driven market. The change in the services offered will need a lot of extensive education and it's even suggested that the government should set specific requirements and demand certain qualifications for those in the market for these consulting services. The auditor's toolbox is going through an extensive education in the services available next to auditing. Important parties will be informed during 2010 of what the removal of the statutory audit will mean.

The fee for auditing will most likely decrease since the auditors will have to compete with accountants and ultimately cut down their prices. In order to obtain a cost advantage some auditing and accounting firms might even join forces. With the removal of the statutory audit for SME:s Swedish companies will be able to compete on the same terms on the international market.

A negative effect is that there will be a decrease in the audit profession meaning that the number of auditors will most likely decrease in the future. When an audit won't be needed in a company, the quality of the financial statements will most likely worsen and auditing will become a specialist function where there will be more consultants and advisory/financial consulting services than auditing. On the

other hand, the value of auditing will most likely increase since the need for quality assurance will be by the parties themselves. It's believed that the majority of small companies will continue with auditing even after the removal of the statutory audit for SME:s where one factor might be because that SME:s will rely more on consultancy and other services, but these services are also costly, so why not continue with the audit instead.

## 10.2 On alternative methods and assurance

### What can be said about alternative methods of obtaining assurance?

It is reasonable to believe that the majority of the companies concerned with the removal of the statutory audit for SMEs will still engage an auditor to provide them with an audit. The users of the audit, the stakeholders, influence over companies will still dictate which financial reports are satisfactory to them. We believe that stakeholders, after the removal, will push company owners to engage auditors because of their interest in an unbiased report which contains a certain amount of quality. There are, however, undoubtedly companies who will choose not to engage an auditor to provide them with this level of assurance, most companies who are of this sentiment probably do not need an audit, since their company is not dependent on third parties to run their business.

It has also been made clear to us, through the interviews conducted, that a large part of both management and third parties have a problem with the distinction between different degrees of assurance as well as separating assurance engagements from related services such as consultation and compilation reports. We agree that the distinctions are currently too vague. An audit is supposed to give *reasonable* assurance while a review engagement is to provide the lower form of *moderate* assurance. It is therefore very difficult for an entrepreneur, with control over a small company, to be completely familiar with these different levels of assurance. Another concern is how the translation will be conducted and received in Sweden, and is it even possible to translate value statements like *reasonable* and *moderate* assurance accurately?

The audit firms can also assist companies in their choice of assurance level. We have learned that the audit firms already have begun to change their approach towards companies that are being affected by this pending legislation. In the long term we are convinced that the dialog between companies and audit firms will improve and an awareness of what level of assurance which is suitable will be more understood.

The tax agency, one of the third parties, is probably the user of the financial statements who will be



affected by the removal of the statutory audit for SMEs. Even though we are fairly certain that only a small part of the concerned companies will choose to deny the audit there will be a decline in quality and assurance with those companies who do. This will only contribute negatively to the Swedish tax agency's ability to investigate and detect fraud and illegal acts, whether the owner of the company is aware or unaware of the misstatement in the financial reports presented.

### **10.3 On economic crime**

#### **What can be said about the risk and occurrence of economic crime in reference to the removal of the statutory audit of small companies?**

We have come to the conclusion that there is a risk that economic crime may rise in the future. An important factor in this is the threshold value that has yet to be decided on. The government has however given a suggestion on this. From the official comments and interviews we have deduced that those in favor of the proposition would prefer higher thresholds and those against would prefer lower.

As the auditor's role as a form of control mechanism is removed, we have found that our interviewee's expect the occurrence of economic crime to rise in the future. The Tax Agency and the Economic Crime Authority conclude that the statutory audit should not be removed for this reason. Without considering the preventive effect and the expected consequences of removing the auditor, the Tax and Economic Crime Agencies could not support the proposal as it seems counterproductive. However all our interviewee's saw the bigger picture and in matters of principle understood why the statutory should be removed and were positive in this respect, the problems they found lie in adjusting to the developments. In order for the Agencies to function efficiently, the control mechanisms in society must be examined more closely.

Which types of economic crime might rise in the future are difficult to predict, but it is expected that economic crime through fault will increase the most. Those predicting this conclude that more faulty tax and income declarations will be sent to the Tax Agency.

# 11 Reflections

*In this final chapter the reader is offered insight on our methodological and theoretical conclusions. Also, our personal reflections are concluded in this chapter along with suggestions for further research.*

## 11.1 Methodological considerations

In the aftermath of this thesis we have taken time to reflect over the methodological approach chosen to tackle the purpose of the thesis. Considering the amount of time and information available during this time we feel that appropriate methods were chosen. As the information available was at times overwhelming much consideration was given to determining which sources were most reliable. As the issues discussed throughout this thesis have been debated and examined through so many perspectives, we found the relying on official reports from government authorities and departments were most reliable. With the triangulation approach in mind, we often cross-examined and checked information found in the media with government and other official reports. If, after this, there still remained unclear issues we were able to discuss these with our interviewees, who all are very well familiar with the current situation. For these reasons we consider the triangulation approach to be most appropriate when considering alternative research approaches.

During the actual process of collecting information, we again turned to the media arena to gain understanding on which issues were most important and how they were being tackled in the the media. This however did not give any deeper understanding of the core issues, but was essential in contributing to the full spectrum of the situation. The biggest difficulty was encountered during the process of selecting and finding interviewees who could participate in this study. Grant Thornton was contacted two months prior to the thesis writing period as we wanted to ensure their participation as early as possible. Government authorities on the other hand were not as easy to get a hold of which somewhat delayed our time schedule. If more time had been available we could have selected more official comments to the SOU 2008:32 report and seek these parties out for further interviews and comments. We found that this approach to be very useful as the official comment served as a common ground and good point of departure for the interviews. This meant the interviewee could first respond to the statements in the official comment and then later on share their more personal reflections on the issues discussed.

We believe that the reliability of this study is strong, as we have thoroughly examined the information presented from different perspectives and sought the primary sources to the extent possible. The issue of validity is more difficult to assess as the result could differ if the study were to be replicated by other

researchers. On one hand, the actual answers and information gathered would not differ, but on the other the interpretation of this material might.

## **11.2 Theoretical considerations**

The theoretical framework of this thesis consists of a section focusing on the fundamentals of auditing and audit services. The aim of this was to inform the reader on basic concepts and then to later introduce what yet has to be regarded as typical alternative services, such as the compilation or review reports, in the Swedish accounting profession.

In order for the reader to fully understand what is currently happening in the Swedish accounting profession we deemed it necessary to shift focus somewhat and examine the development in foreign countries. This was not so much intended to become a ground for comparison but more for the reader to understand the harmonization process in Europe and what the removal of the statutory audit has meant in other countries. Together with the background, historical review and the update on the current debate, we believe the reader has been given an overall holistic view of the subject, and an adequate frame of reference to be able to understand the thesis analysis and conclusions.

In retrospect, we believe the reader would have benefitted from a more theoretical approach to economic crime. However, as the main purpose of this thesis was to contribute to the ongoing debate, this approach would perhaps have been too deep for this study.

## **11.3 Suggestions for further research**

During the course of writing this thesis it has become apparent that there still remains issues in need of further research. For example, a more extensive examination of the thresholds should be done before selecting a set of values in Sweden. The UK experience has taught us that the thresholds can be raised over time, although this approach is perceived as more costly, it is a more careful approach. When interviewing the Economic Crime Authority it also seemed that not so much government resources had been put on examining the consequences for economic crime. At first we thought it be most logical to compare the Swedish development to the Danish and perhaps draw conclusions out of this. If something could be said about the Danish economic crime development before and after the removal, then perhaps this could be an indicator of what is to be expected in Sweden. Another aspect we found interesting has to do with the alternative methods, such as the review and compilation reports. It would be interesting to examine the basic knowledge of these services with working professional accountant and accounting consultants. Furthermore, a more in-depth analysis on the so called "Auditor Toolbox" would be an interesting research subject in the future.

## Appendix

This section contains example reports from the compilation report, audit report and review engagement. All examples follow the IFAC guidelines. After these examples, the interview questions used in the online and personal interviews are presented, these together are the interview guide referred to in the methodology chapter.

### COMPILATION REPORT

On the basis of information provided by management we have compiled, in accordance with the International Standard on Related Services (or refer to relevant national standards or practices) applicable to compilation engagements, the balance sheet of ABC Company as of December 31, 19XX and statements of income and cash flows for the year then ended. Management is responsible for these financial statements. We have not audited or reviewed these financial statements and accordingly express no assurance thereon.

ACCOUNTANT

Date Address

## INDEPENDENT AUDITOR'S REPORT

### Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>13</sup> An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### *Opinion*

In our opinion, the financial statements give a true and fair view of (or "present fairly, in all material respects,") the financial position of ABC Company as of December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

### Report on Other Legal and Regulatory Requirements

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Date of the auditor's report]*

*[Auditor's address]*

## ENGAGEMENT LETTER FOR A REVIEW

The following letter is for use as a guide in conjunction with the consideration outlined in paragraph 10 of this ISRE and will need to be varied according to individual requirements and circumstances.

To the Board of Directors (or the appropriate representative of senior management):

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will review the balance sheet of ABC Company as of December 31, 19XX, and the related statements of income and cash flows for the year then ended, in accordance with the International Standard on Review Engagements (ISRE) 2400 (or refer to relevant national standards or practices applicable to reviews). We will not perform an audit of such financial statements and, accordingly, we will not express an audit opinion on them. Accordingly, we expect to report on the financial statements as follows: (see Appendix 3 to this ISRE)

Responsibility for the financial statements, including adequate disclosure, is that of the management of the company. This includes the maintenance of adequate accounting records and internal controls and the selection and application of accounting policies. (As part of our review process, we will request written representations from management concerning assertions made in connection with the review.<sup>3</sup>)

This letter will be effective for future years unless it is terminated, amended or superseded (if applicable).

Our engagement cannot be relied upon to disclose whether fraud or errors, or illegal acts exist. However, we will inform you of any material matters that come to our attention.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our review of the financial statements.

XYZ & Co

Acknowledged on behalf of ABC Company by

( signed ) .....

Name and Title Date

<sup>3</sup> This sentence should be used at the discretion of the auditor.

## Interview Guide

The interview guide was designed to fit all the professionals interviewed, more time was however spent on certain topics depending on the interviewee's special competence. The goal was however to discuss all the topics presented in the guide, along with questions prepared beforehand. The topics however allowed for more open forms of interviewing, more semi-structured interviews, giving both us and the interviewee to focus on certain questions that seemed more interesting and also made way for further follow-up questions.

### Om revisionspliktens avskaffande

Hur tror Ni att avskaffandet av revisionsplikten kommer att påverka Ert nuvarande arbete samt företag i helhet?

Bakgrunden till avskaffandet av revisionsplikten för små och medelstora företag är att minska deras onödiga administrativa kostnader, och arbetet för en harmonisering av revisionsyrket i EU. Vad anser ni i denna fråga, kommer företagen att gynnas?

Avskaffandet innebär att revisionstjänster konkurrensutsätts vilket är fundamentet i en fungerande marknad. Hur har Ni förberett Er på förändringarna?

Syftet med revisionen är att förmedla en kvalitetssäkring till kunden och dess intressenter. Hur tror Ni att avskaffandet kommer att påverka småföretagarnas framtida trovärdighet om dessa väljer bort revisorn?

Konsekvensen av revisionspliktens avskaffande blir att marknaden för revision blir efterfrågestyrd. Vilka för/nackdelar finner Ni med detta?

En fördel som vi anser kan finnas är att förväntningsgapet mellan revisorn och klient kan komma att minska. Eftersom det kommer att finnas olika grader av "assurance" tjänster kommer kunden i allt större uträkning tala om vad just denne behöver. Då ökar ju samsynen på vad den aktuella tjänsten går ut på. Frågan är vad Ni tror om detta resonemang?

Man kan även tänka sig en motsatt effekt, att förväntningsgapet ökar då revisorn kommer att arbeta mer med rådgivning och konsultuppdrag för att kunna behålla sina kunder. Blir inte samsynen på revisionsyrket och vad en revisor de facto gör vagare?

### Om utbildning och yrket

För att kunna bli revisor krävs ett teoretiskt prov efter ett antal års praktisk erfarenhet. I dagsläget är det närmare 50 % som klarar provet vid första skrivningstillfället. Vägen till att bli revisor är med därmed inte helt lätt. Anser Ni att det finns en risk att färre studenter kommer att vilja vidareutbilda sig till god/auk. revisorer i framtiden om avskaffandet innebär en minskad fråga på revisorns tjänster?

I om med avskaffandet kommer närmare 97 % av Sveriges små och medelstora företag att kunna välja bort sin revisor. Hur tror Ni att efterfrågan på revisorns tjänster kommer att påverkas?

### Om ekonomisk brottslighet

Revisionsplikten introducerades som en åtgärd för att minska den ekonomiska brottsligheten. Vad anser Ni om risken att denna form av brottslighet ökar genom revisionspliktens avskaffande.

Tror Ni att den ekonomiska krisen kan vara en påverkande faktor i hur småföretagarna ställer sig i frågan om att behålla revisorn eller inte? Vad tror Ni om sambandet mellan ökad ekonomisk brottslighet under lågkonjunkturer?

Revisorn har idag en roll i att upptäcka och i någon mån förhindra ekonomisk brottslighet, dvs. medvetna och omedvetna fel. Om revisorn försvinner kommer därmed även en viss kvalitetssäkring försvinna. På vilket sätt kommer kvalitetssäkringen att i så fall fungera i framtiden?



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