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The abolishment of the audit duty for Swedish SME's

- A study seen from the banks' perspective

Master Thesis within Finance

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Avskaffandet av revisions- plikten för Svenska SMEs

- En studie ur bankernas perspektiv

Magisteruppsats inom Finans

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Master Thesis in Finance

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Abstract

Background

In 2006 the audit duty for SME's was abolished in Denmark, and January 1st 2007 Finland decided to do the same. The subject is now under investigation in Sweden since the government has appointed an investigation dealing with the future of the audit duty for small companies. The report will not only investigate whether an abolishment needs to be done but also if compliments are needed in order to prevent companies from breaking the rules, intentionally or unintentionally due to lack of knowledge.

Purpose

To investigate how a possible abolishment of the auditing duty for small companies will affect the creditors' ability to assess the company's creditworthiness.

Method

The selected sample of this study contained interviews with five organisations that would be affected differently of an abolishment of the audit duty. The authors wanted to interview organisations with different perceptions of the audit duty although the organisations have in common that they all possess knowledge which is important to the banks in the credit rating process. The sample consists of representatives from; FAR SRS, Företagarna, Handelsbanken, Nordea and Upplysningscentralen.

Conclusion

All the different organisations in the study showed different views in the value of having audited financial statements. FAR SRS and Företagarna were, as could be expected, most and least in favour of having audited financial statements. UC did not predict to be affected by an abolishment, but did see a value in it. Interesting conclusions could be seen between the banks. It showed that depending on the organisational structure different value was seen in the audit duty. This addresses how important a bank's routines are in the process of valuing a company's creditworthiness. The study showed that an abolishment will probably turn the focus in the credit process from the information that figures generates. The information used to assess a company's creditworthiness would to a larger extent be on analysing the business concept, the environment and the resources that a company posses.

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Sammanfattning

Bakgrund

2006 avskaffades revisionsplikten för SMEs i Danmark, och första januari 2007 gjorde Finland samma sak. Ämnet undersöks just nu i Sverige sedan regeringen har begärt en undersökning angående framtida revisionsplikt för SMEs. Rapporten handlar inte bara om huruvida revisionsplikten bör avskaffas, utan också om några komplement kommer att behövas för att motverka att företag bryter mot de redovisningsregler, avsiktligt eller icke avsiktligt, som en följd av bristande kunskap.

Syfte

Att undersöka hur en möjlig avskaffning av revisionsplikten för småföretag kommer att påverka kreditgivarnas förmåga att värdera ett företags kreditvärdighet.

Metod

Det valda samplet i den här studien består av intervjuer med fem organisationer som på olika sätt kommer att påverkas av en slopning av revisionsplikten. Författarna önskade intervjua organisationer som har olika uppfattning av värdet på revisionsplikten, men samtidigt har gemensamt att de har ett brett kunnande i frågan. De valda organisationerna har också gemensamt att den information de har är viktig i bankernas kreditprocess. Samplet består av representanter från; FAR SRS, Företagarna, Handelsbanken, Nordea och Upplysningscentralen.

Slutsats

Alla organisationer i studien visade sig ha olika uppfattning om värdet av att ha reviderade årsredovisningar. FAR SRS och Företagarna var, vilket var väntat, mest respektive minst för reviderade årsredovisningar. UC förutser inte att de kommer att bli påverkade av en slopning av revisionsplikten, men ser fortfarande ett värde i den. De mest intressanta slutsatserna kunde finnas hos bankerna. Det visade sig att beroende på organisationens struktur såg ut hade man olika syn på värdet av revisionsplikten. Detta visar hur viktig bankens arbetsätt är i processen för att värdera ett företags kreditvärdighet. Studien visade att ett avskaffande av revisionsplikten sannolikt kommer att vända fokus i kreditprocessen från information hämtad med användning av siffror. Informationen som används för att bedöma ett företags kreditvärdighet kommer mer att bero av analyser av företagets koncept, företagsmiljön, och de resurser som ett företag besitter.

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1 Background

In this chapter an introduction of the subject of this thesis is presented. The introduction will develop into a problem discussion where the research questions and the purpose are presented. The chapter ends with the delimitations as well as some definitions that are important for this thesis.

1.1 Introduction

The European community's fourth directive discusses the auditing duty for companies. It is possible for the member countries to choose if they want to keep the auditing duty for small companies or whether it should be abolished. The European Union (EU) has stated some maximum threshold values that the companies cannot exceed in order to be classified as a small company, but it is completely up to the countries to decide whether they want to use the predetermined figures or have lower. (Halling, 2003)

The Nordic member countries and Malta have until last year been the only countries, except for the recently new members, that still have had the auditing duty for small companies. As with most big decisions it is often a matter of politics. Denmark abolished its auditing duty for small companies March 21st 2006 and the decision was made January 1st 2007 in Finland. Both countries have chosen to have narrower threshold limits than what the EU has set as its limitations. In the Danish case only a short time has passed since the introduction, and due to this it is hard to say what the outcome of the change can be. Some research has been done on the topic and it shows that only a 17 per cent of the companies have chosen to have audited financial statements. The discussions in Denmark have been on who the beneficiary will be in reality. Some claim that the government is the real winner and that is why they decided to abolish the auditing duty in the first place. The actual reason why companies in Denmark chose not to take advantage of the new rule and save money and not have audited financial statements is still unknown. It is though interesting that the research used as a base for the decision showed that small companies would really benefit from it have chosen not to take the advantage. (Aggestam Pontoppidan, 2007) Finland has yet only accepted the law, but the companies will not be able to use the new regulations until this summer. The strongest argument in favour of the proposition was that the small companies would be able to save money by not having to pay the fees that are paid for accounting and auditing. Another argument was that financial statements for small companies are made for the owners and that is usually the owner and the person preparing the statements is the same person. (RP 194/2006 rd)

At the moment Bo Svensson is leading a group investigating the Swedish case. He was designated by the former government to make a proposition, which is scheduled to be presented September 10th this year. The report will not only investigate whether an abolishment needs to be done but also if compliments are needed in order to prevent companies from breaking the rules, intentionally or unintentionally due to lack of knowledge. The underlying reason for bringing up the issue are two factors. The first one is the international perspective, which due to the increasing trade between countries is affecting both large and small companies. The second argument are concerned with that Sweden is part of a European collaboration amending regulations for small companies. (Thorell & Norberg, 2005). Discussions about the pros and cons have been going on for years in Sweden, and as with the Finnish and Danish case there are well spoken arguments on both sides.

1.2 Problem

Banks are positive towards companies producing audited financial statements. However, exactly how important compulsory audited financial statements are in order to determine if a company is creditworthy is a crucial question. Also compared with the possible advantages that a small company may gain from not being obligated to audit their financial statements, the bank's interest in the matter must be put into the whole context. (Thorell & Norberg, 2005) Apart from audited financial statements the bank uses credit reports from companies specialised in this area. An example of a credit report company is Upplysningscentralen (UC) which is mainly owned by the large commercial banks in Sweden; Swedbank, Handelsbanken, SEB and Nordea. Since the services that UC provides to their customers are financial statements a definite problem will arise. If UC cannot base its service on reliable information and guarantee its customers a correct scoring of a company its service will to some extent be worthless. This will naturally affect the creditors' possibility to value companies. Although the banks are not solely basing their decisions on the credit scoring they are purchasing from UC it is a safety they have. Karin Markstedt at Nordea discusses the importance of a company's financial statements when valuing its creditworthiness. She stresses the fact that the Bank does not only have a brief look at the accounts, but that they are thoroughly analysing it. (K. Markstedt, personal communication, 2007-02-20)

Some positive aspects of auditing are difficult to appreciate as they cannot be quantified and this will be a problem for the banks when arguing for the audit duty's existence. An example of such an aspect is the increase in the need for resources when gather reliable information when making credit decisions. (Andersson, 2005) Thus the problems that can arise if the audit duty disappears may have a greater affect than one appreciated.

Most research made both in Denmark and Finland before deciding on whether to abolish the auditing duty or not was focused on the company itself. The authors of this thesis together with Karin Markstedt at Nordea could see a problem in that the creditors view had not been considered (K. Markstedt, personal communication, 2007-02-20). Creditors are an important stakeholder for companies, especially new companies that need some funding to get the company up and running. Due to the lack of research being done from the stakeholders view the authors decided to analyse the problem further. This will be done by using the following research questions;

- How is an abolishment of the audit duty viewed by organisations that are represented in the thesis?
- How would the information that needs to be given to the banks in order to make a fair valuation of the company's creditworthiness be affected by an abolishment of the audit duty?
- As a consequence of an abolishment of the audit duty what possible differences will occur for the organisations represented in this study?

1.3 Purpose

The purpose of this thesis is to describe how an abolishment of the audit duty for small companies will affect the banks during their credit rating process and also see how Företagarna, FAR SRS and UC will be affected.

1.4 Definitions

- **Creditworthiness:** “A creditor’s measure of an individual’s or company’s ability to meet debt obligations.” (Webfinance, 1997-2000)
- **Small and medium sized companies:** In this thesis this term refers to;
 - * 50 employees
 - * €7.3 million in turnover
 - * Total capital employed of €3.65 millionAccording to the threshold values set by the European Union, to determine the maximum values allowed for a company that can make use of the audit exempt. (Halling, 2003)

2 Method

The method chosen for this thesis is a qualitative research method where open interviews are the main tool used for the data collection. In the chapter the authors will present why such a method is used and how the interviews were conducted.

2.1 Qualitative vs. Quantitative Research Methods

When doing a study the authors have to decide on which research method that is most beneficial in order to achieve a good result. This includes the decision whether a quantitative or a qualitative research method should be used. The distinction between the two methods has been discussed and to understand the difference one has to take into account both how it is collected as well as how the data is analysed. They both have pros and cons and choosing the wrong method might lead to a biased result of the study. (Saunders et al., 2003)

Three characteristics for data to be classified as qualitative were stated in Saunders et al. (2003); it has to be based on words; the result of the data needs to be classified into categories; and the analysis must be made using conceptualisation. There are different types of qualitative methods to use and the authors felt that the data that would contribute best to fulfilling the purpose of this thesis would be in depth open interviews and based on this the decision to make a qualitative study was made. When using interviews there are some pros that the authors believe will contribute to increase both the validity as well as the reliability of this study. Four of them are stated by Saunders et al (2003) and will be discussed in turn of examination. The first one is the nature of the approach for the research which deals with the aspect of using interviews. Here the interviewers have the chance to elaborate further on the questions and can by doing that eliminate any misunderstandings or misinterpretations of the questions. In this thesis the authors chose to perform open interviews with the respondent in order to achieve the best possible result. The second is the significances of establishing personal contact. This is connected with the first point in the way that it gives an extension to the questions, but the most important difference for other type of qualitative methods is that when meeting someone face to face the interviewer have the possibility to ask awkward questions and by that forcing the interviewee to answer questions that s/he would have left out using a questionnaire. The third is the nature of the questions. When doing an in depth interview the questions can be both longer and more complex, hence more complicated questions can be asked. The last point which is connected to the third is length of time required and completeness of the process. It is hard to develop a questionnaire that will cover as much as an in depth interview. Having all the above mentioned points in mind the authors could only find pros with using in depth interviews. These since the number of interviewees are limited to quite few and the topic chosen have not been investigated yet. Having used another type of qualitative method might have made the authors miss out on important aspects of data to collect.

When using a quantitative method, one can apply a standardized approach to analyse the result. In this thesis a qualitative research method is used instead and there are no standardised approaches available, then it is of great importance that the authors can structure the result and make sure that the same analyse is performed according to the same standard for all the respondents input. In this thesis this is done by using interview guides for every interview.

2.2 Method chosen

After deciding on using a qualitative research approach the authors choose how to conduct the research. It was determined that the best suitable way to collect the empirical findings for this thesis were through interviews. These interviews were held with a number of people that represents different organisations which will in different ways be affected by an abolishment of the auditing duty.

Having decided on performing interviews during the data collection phase, the authors choose one specific method for how the interviews should be made. Different methods give different information. There exist different types of interview methods which a researcher can use in order to reach his/her purpose of the thesis. For this study the authors decided that an in depth open interview method was the most suitable for the purpose. The reason for this is that there are few previously done reports in this particular subject. In an open interview one look for different definitions of a phenomenon. This method is used if the researcher wants to increase the knowledge in a subject. In the contrary, a structured interview gives several answer alternatives to choose between, which are determined in advance. (Lantz, 2007)

In order to get the best possible result from the interviews it is important to have in mind that one does not interpret the data in the wrong manner. The researcher has to be aware of the fact that s/he is having personal expectations, desires and experiences as a foundation for the interpretations that are made during the analysis of the data. If the data are to be seen as valuable it has to be analysed in a critical way making sure that the proper questions have been asked and the fair view of the interviewee has been reflected. (Lantz, 2007)

When performing an open interview an interview guide is needed to make sure that the conversation is holding a specific track that the authors wish to investigate. The interview guide has preferably between four and six parts to be covered, which in turn can have several open questions. During the open interview the researchers can start each part by giving the interviewee a chance to freely discuss the subject area. Thereafter one makes sure that the answers are somewhat concrete and linked to the area that the researchers want to discover. In an open interview one should make follow-up questions and dig deeper into the questions. (Kylén, 2004)

The level of standardisation of the question relates to if all interviewees receive the same questions and if the situation is similar for all of them. A low level of standardisation allows greater variation. (Trost, 1997) In this thesis five interviews are performed with different organisations that are somewhat affected by an abolishment of the auditing duty. Since each interviewee represents different standpoints and views regarding the auditing duty, the authors found it necessary to have a low level of standardisation for the open interview.

2.3 Sample selection

As the first step of the thesis the authors contacted Karin Markstedt, the head of Credit- and industry analysis at Nordea. An informal interview was conducted in order to get valuable preknowledge in the area which helped when shaping the thesis and determine which angle and purpose to focus on. The interview will not be a part of the empirical findings instead the information found during the discussion is a part of the first chapter of the thesis.

The sample set for the empirical findings consists of five different organisations which will be affected by an abolishment of the audit duty in some way. The authors wanted to interview organisations with different perceptions of the audit duty although the organisations

have in common that they all possess knowledge which is important to the banks in the credit rating process. The following organisations and also the best suitable interviewee within each organisation were selected; they are presented in alphabetical order:

- **FAR SRS:** FAR SRS is the trade association for auditors and advisors representing approximately 4000 members. (FAR SRS, 2007) Bengt Skough, responsible for the area of small and medium sized companies is the representative of FAR SRS in this thesis. The goal with the interview with FAR SRS is to get a general view on the auditing industry's perception of the value of having the auditing duty, and what consequences an abolishment of the duty can bring.
- **Företagarna:** Företagarna is the largest trade organisation in Sweden and represents 55000 directly connected businesses as well as 16 trade associations. The members of Företagarna are either company owners or supporters of Företagarna. (Företagarna, 2007) Annika Fritsch with the expertise in taxes and company law is the representative of Företagarna in this thesis. The authors are interested in Företagarna's general view on how small companies will be affected by an abolishment of the auditing duty, but not a specific company's problems that will occur when the auditing duty is abolished.
- **Handelsbanken (SHB):** Handelsbanken is a bank with a strong market position in the Swedish market. (Handelsbanken, 2007) The respondent representing Handelsbanken is Lennart Francke which is the expert representative for the bank industry in the investigation of accountants and auditors. The reason for choosing SHB is that they have a highly decentralised organisation which distinguishes them from the other banks. The authors wanted to see whether this decentralised bank had the same expectations and attitude towards the abolishment of the audit duty.
- **Nordea:** Nordea is a leading banking group in the Nordic markets providing products and services within banking, insurance as well as asset management. (Nordea, 2007a) Per Svenningsson is the head of Credit analyst's in the Jönköping region and the representative of Nordea in this thesis. As Nordea Jönköping is a creditor in a region where it exist many small companies, the authors wanted to attain Nordea's view on how an abolishment of the auditing duty may affect its organisation.
- **Upplysningscentralen (UC):** UC is the largest business and credit information supplier in Sweden. (UC, 2007) In this thesis UC is represented by Mikael Eklund who is responsible for the incoming data at UC and Mats Jonsson responsible for the annual report collection. The goal with interviewing UC is to investigate how the business and credit information agency perceive the abolishment of the auditing duty as UC is on of the banks' supplier of information needed during the credit rating process. The authors were also interested in finding out how UC perceived the future of their products.

The authors also contacted Svenska Kreditföreningen and Sparbankernas Riksförbund to extend the sample, but they did not show any interest.

2.3.1 The interview procedure

After deciding on which organisations that had the knowledge that the authors wanted to gain it was important to find the right person within each organisation. E-mails were sent to the organisation's information centre or directly to a person who was responsible for the area of which the authors were interested in. In the cases where the first contact was taken with the information centre the author's inquiry was redirected to the suitable respondent.

Four interviews were performed face-to-face at the respondent's location. The interview with Nordea was conducted at the Jönköping office and the authors met FAR SRS, UC and Företagarna in Stockholm. During the interviews both authors were present and both were active in the discussion as well as taking notes. During two of the interviews the authors had access to a tape recorder, unfortunately this was not possible for the other two interviews.

The interview with Handelsbanken was conducted through e-mail, where the interview guide was sent to the respondent who answered the questions and returned it. E-mail interviews were used due to lack of time to perform face-to face interviews. As the questions were thoroughly answered the authors felt satisfied with the interviews and did not have to ask follow up questions.

2.3.2 The interview guide

Before conducting the interviews one interview guide was prepared for every respondent (see appendices). The interview guides had tailored made questions for the specific respondent in order to focus on the knowledge of that specific organisation. Each respondent received the interview guide by e-mail a few days before the interview took place to give the interviewee the chance to prepare and be able to answer the questions in best possible manner.

Although the whole sample did not receive the exact same questions, the interview guides were built according to the same structure; the audit duty, information, company valuation and credit rating. Since some of the respondents did not perform company valuation or credit rating yet did not possess that knowledge, these interviews were instead focused on the audit duty and the information collection instead.

2.4 Validity and reliability

The importance of the method used in a study is not to be understated. It is after all a part of the credibility of the study made. The validity and the reliability of the study are two important criterions that must be addressed when evaluating the method used in a study. Easily explained one can say that the former is concerned with the question whether the result are what they seem to be and that the latter is whether one can trust the result. (Saunders, Lewis & Thornhill, 2003) The authors will naturally always try to achieve a valid and reliable result, but there are influences that must be addressed which might generate an unwillingly biased result.

Important when trying to find a valid result is to see whether one can deduce a relationship between the variables in the study. Meaning that if one can draw the conclusion that the variables used have affected each other. This puts pressure on the authors since the analysis and the conclusion will be a product of the method used. (Saunders et al., 2003) The authors have chosen to interview people that represent different angles of the problem that is investigated, and by this will be able to collect data from different perspectives which will hopefully generate a valid result. The authors are of the opinion that using open interviews will give the most valid result for this study, since the purpose of this thesis is to analyse a problem that probably will arise in the future. The authors believe that the chosen interviewees are suitable as they possess broad knowledge about the topic which will help generate a valid result for the thesis.

Discussions on what type of interviews and questions that will be performed are important when trying to find a valid and reliable result. Saunders et al., (2003) argued that in order to

reach a valid question that will give a true answer the data has to be collected constantly. This is not possible for this thesis but the authors have chosen to focus on other inputs that will hopefully increase the credibility of the data. One thing that can affect the result and that can be controlled is how the result is measured. If the authors are careful when doing the interviews and make sure that the interviewees fully understand the questions from the angle that the interviewers have intended them to be it will increase the validity. Face-to-face open interviews are thus appropriate. This is discussed by Froddy (1994:17) in Saunders et al, (2003) and he addresses the importance of the questions and answers making sense. In this thesis the authors will try to achieve this by e-mailing the questions in advance combined with carefully thought through questions. Structuring the questions in an interview guide will be one way of making sure that the focus of the thesis is held. What has to be considered is that no matter how well prepared the interview is the human factor has its influences, not only on the interviewers but on the respondents as well.

After producing a result that the authors believe to be valuable the question of the reliability have to be considered. When using interviews as research method some questions have to be addressed by the interviewers, for example can the interviewee be trusted? This not necessarily meaning that s/he is lying, but rather that the interviewee lacks the knowledge or has misinterpreted second hand information of the topic (Saunders et al, 2003). The authors hope to diminish this by carefully choosing the interviewees representing companies that have good knowledge within the topic. In those cases where an information centre at the organisation were first contacted, it was of importance to explain what type of question the authors wanted to ask and to request for a suitable respondent.

3 Frame of reference

The frame of reference starts with a presentation of how the abolishment of the audit duty has proceeded in England, Denmark, Finland and now also Sweden. The chapter also presents different theories associated with credit rating and company valuation.

3.1 Abolishment of the auditing duty

In the European Community's (EC) fourth directive for corporations article 51 it is stated that it is compulsory with audited financial statements and revised director's reports. (Halling, 2005) However, for all countries within the European Union it is possible for each member to determine whether small companies are put under the obligation. The European Union has determined a set of threshold values and in order to avoid the audit duty the company cannot exceed two of the three values for the last two financial years:

- 50 employees
- €7.3 million in turnover
- Total capital employed of €3.65 million

These threshold values are an outer boundary for what is accepted and it is free for the member of the European Union to determine whether to narrow these values down or not. (Halling, 2003)

3.1.1 Audit abolishment in England

In England the audit duty was abolished already in 1993 for the smallest limited companies. Since then the threshold values for audit exemption have been increased three times; in 1997, 2000 and 2004. At time being England's limit is the same as the EU's maximum threshold limits. However, the exemption of auditing is not a possibility for publicly traded companies that run a financial operation. In order to protect minority interests in a company there is also a rule that allow shareholders in possession of at least 10 per cent of the capital to demand audited accounts. (Thorell & Norberg, 2005b)

What makes the English case interesting to look into is that the audit exemption is built upon a specific philosophy on how to set regulations. This regulation philosophy aims at decreasing the cost for small and medium size enterprises in order to strengthen their competitiveness and a way of decreasing cost is to facilitate the rules for the companies. The regulation philosophy can be seen as a cost-benefit analysis and if the cost exceeds the benefits of a regulation then it is abolished. Further the philosophy is an extension of the evidence based policy making approach which derives from the fact that the government's politics is founded by empirical studies on the specific subject. (Thorell & Norberg, 2005b)

An example of an empirical study made according to the evidence based policy making approach is "Director's vies on exemption from the statutory audit" made by Jill Collis in 2003. The study was commissioned by the Department of Trade & Industry in England prior to the increase of the threshold values for audit exemption made in 2004. Collis (2003) sent questionnaires to 2633 active, independent, unlisted small companies and had a few follow-up interviews with auditors and directors. The response rate was 30% thus 790 companies and the non-respondents were likely to be the smallest companies in terms of number of employees. From the study it was found that in 2002, 58 per cent made use of the audit exemption and the reason for doing so was the lower accountancy fees.

Many companies were not able to state the exact amount saved, however typically £1000 was claimed to be the amount saved. The 42 per cent of the companies that still filed audited accounts stated that except for the company's desire to use auditing also the continuation of company policy was a reason. The study also revealed that the directors of a company are more likely to use auditing if the company possesses the following characteristics;

- large in terms of turnover
- not wholly family owned
- has shareholders which do not have 100 per cent access to the internal financial information
- the directors perceive auditing as improving the quality of the financial reports
- auditing will have a positive effect on a credit rating score
- the directors perceive auditing as an effective control of the accounting records and systems
- the directors usually give a copy of the statutory accounts to the bank and other investors.

(Collis, 2003)

3.1.2 Audit abolishment in Denmark

The member countries of the EU are not only expanding in numbers, but more and more common laws and regulations are developed for the countries. The Nordic countries do not have the exact same business climate and some cultural differences exist. On the other hand one must argue that the Nordic countries probably have more in common than what they have with many of the other countries in the EU. Recently Finland and Denmark have introduced a new accounting principle saying that for small companies it is not compulsory to have audited financial statements.

March 21st 2006 the audit duty was abolished for Danish companies which are in the L 50 category. The limitations that constitutes that a company are allowed to be in the L 50 category is that it cannot have a total capital employed of maximum 1.5 million DKK, a net turnover of maximum 3 million DKK and an average of twelve employees. The rule in Denmark is that if a company fulfils two of the three criterions it can choose not to publish audited financial reports. The discussion that was the foundation of the Danish decision has been under investigation for several years, but the decision was made based on a report published in 2005 saying that 75 000 small companies would be affected by the new regulations. (Aggestam Pontoppidan, 2007)

As with many other topics originating from the EU the force behind the addressing of the matter was political. The current government claimed that an abolishment of the auditing duty for small companies would decrease the administrative expenses and hence the Danish companies would be more competitive against other countries in the EU. The goal set by the government is to decrease the expenses with 25 per cent before 2010. (Nye mål, regeringsunderlag, 2005 in Aggestam Pontoppidan, 2007) Entry barriers in terms of administrative expenses for companies in small countries are certainly not necessary when trying to compete with strong countries as for example Germany or France. Lowering expenses for small companies is a well discussed topic in politics as well as in academia, and if the abolishment of the auditing duty would benefit the small companies that would lead to a possible boost of the country's economy. Another aspect of the matter is that some critics have stressed the fact that the government itself might be able to save money by introducing the new auditing regulations, even if it is only predicted to be a fairly small amount. Since the

regulations have only been allowed for just about a year, the question of who it will benefit most in the Danish case cannot yet be answered. The report on the matter claimed that the companies would be able to save a total of 677 million DKK. Discussions in the media have been that the possibility that the figures might be a bit twisted. The reasoning behind this is whether it is possible for the companies to benefit much more financially than what the government is predicted to do. That question is still to be answered, since not enough time has yet passed. (Aggestam Pontoppidan, 2007)

The advantage for the companies does look beneficial, but as with all new regulation teething problems are likely to occur. One of the questions that have been raised in Denmark is if the companies will choose not to have audited reports when it is not compulsory. Research claims that 70 per cent of the companies will choose to still have audited financial statements, but the Danish government's department in charge of corporate questions argues that only 40 per cent will continue. The introduction phase is as have been argued above a natural teething problem, and the latest research shows that 83 per cent of the companies have chosen to still have audited reports. One of the most discussed arguments in Denmark why so few companies have chosen to benefit from the new rule is that it must be approved at the annual general meeting, and hence have delayed the process. Whether this is just an excuse from the people in favour cannot be said since not enough time has passed to find any answer to the matter. (Aggestam Pontoppidan, 2007)

Another, and possibly one of the most interesting, topics is the lack of knowledge. This problem can be viewed from two different angles. First the lack of knowledge on how to apply the new method as well as the benefit that it might generate the company. The second way is the lack of knowledge on how to correctly account that the small companies might face if they decide not to have audited statements. The former has in Denmark been the base of some concern for the companies, and they have argued that they do not want to take a stand in the matter until they believe to have enough information. The latter issue is still to await a result from, and what the result from that will be is impossible to know. (Aggestam Pontoppidan, 2007)

What seems to be the biggest problem in Denmark is that the companies have not yet been convinced that the benefits are in. They are not persuaded that the expenses will be smaller or what the effect will be. These are both highly important matters that most likely will have to have an answer before it will be possible to see any lasting outcomes of the new regulations, and whether it actually is a benefit for small companies to not publish audited annual financial statements. (Aggestam Pontoppidan, 2007)

3.1.3 Audit abolishment in Finland

In Finland a new auditing law was accepted January 1st 2007, and that included that small companies do not have to publish audited financial statements. Due to the recent introduction no research of the outcome of the abolishment has yet been published, but some similarities between the accepted Finish proposition and the Danish report earlier discussed can be found. (RP 194/2006 rd)

The first argument addressed in the Finish proposition is once again the expense aspect. According to the proposition the major reason for the abolishment is that it is accepted in order to reduce the costs for small companies and they are at the same time arguing that they are not in the same need for them as larger companies are. They are arguing that the auditing is most of the time in the interest of the owner, and in small companies the owners are the same as the people that are preparing the financial statements. Hence there is no

need to have audited reports due to the fact that they are actually preparing them for themselves. Whether this is accurate can be argued since the owners are not the only important stakeholders a company have. Even if it only concerns a nearby corner shop one certainly must include landlords and credit institutes as important stakeholders. Suppliers delivering on credit might also want to know that the company is creditworthy. (RP 194/2006 rd)

The proposition has stated some limitations for companies that can be concerned by the new regulations. To be in the category the company cannot go above two out of the three following criterions; have a total capital employed of more than €100 000; a turnover of above €200 000; or an average of employees of more than 3. What can be deduced from the figures is that the Finns have chosen to have more restricted rules and hence a more narrow definition of the size of the companies that fit the category. Whether this is a pro or a con can only the future tells. One argument that can be addressed is that if it is only the smallest companies that are in fact allowed to use the new regulations it is probably the ones that has the least to loose who are actually using it. A Pizzeria or a Corner shop's financial stakeholders are probably less interested in the company's financial statements than what they are in a small manufacturing company. If the company fulfils the criterion to be a company that can chose not to have audited reports the decision is to be made during the next annual meeting in the articles of the association. (RP 194/2006 rd)

3.1.4 Audit abolishment in Sweden

The Swedish government with Fredrik Reinfeldt in charge has appointed an investigation dealing with the future of the audit duty for small companies (Sandén, 2007). It is the Confederation of Swedish Enterprise together with the government that see an abolishment of the audit duty as a mean to simplify for small corporations and decrease their administrative tasks. (Svanström, 2006) This investigation is led by Bo Svensson, vice chairman of FAR SRS's disciplinary committee. The investigation is divided into three parts and starts off with a proposal of amendments needed for completing the EC directive which will be presented 10th of September 2007. March 31st 2008 will be the due date for the second part of the investigation which is a report covering the abolishment of the audit duty and finally a report on the 1st of September 2008, commenting the disqualification of auditors in a company due to the relation with the owners. According to Bo Svensson, the most important question to answer when investigating the abolishment of the audit duty in Sweden will be if there is a need for a complement. (Precht, 2007a)

The reason why Sweden has brought the audit duty to the agenda can be a result of two factors. First, the international development is important and it is affecting Swedish auditing behaviour. However the standards that exist are dealing more with the big corporation and are therefore not suited for smaller companies. The second aspect has to do with the amendments for small corporations that several governments are working with in the European Union today which are also part of the Swedish programme. (Thorell & Norberg, 2005a)

A debate of the pros and cons of the audit duty and its future has been going on for several years. Those in favour of compulsory audited financial statements see it as a mean to give the industry structure and also quality by observance of the regulations. The argument of fair competition is used by both sides. Some say that the audit duty gives fair competition (Axenborg, 2005) while others argue that it will lead to difficulties for small companies in Sweden to compete on an international level (Precht, 2007b). The cost effect of auditing as well as the time consumption are common arguments for the abolishment of the audit duty. However, in a study made by Tobias Svanström in 2006 it is found that the majority

of the companies in the sample perceive auditing as a useful tool which gives important inputs and knowledge to the company thus the benefit exceeds the cost. In fact the study shows that 67 per cent of the smallest companies would choose auditing voluntarily.

In 2005 the two professors Per Thorell and Claes Norberg was commissioned by the Confederation of Swedish Enterprise to investigate the audit duty in small consolidated companies and take a stand on their view of the auditing obligation. They found that there were more positive aspects than negative of abolishing the audit duty. Apart from the advantages and disadvantages already mentioned these two professors also saw opportunities instead of problems for the different creditors of the company. Banks for example are in general seen as a great beneficiary of having the audit duty, although Thorell and Norberg (2005b) perceived their need for statutory auditing as convenience rather than a necessity. It is a fact that a bank can demand audited financial statements in order to receive a credit, instead without the audit duty the bank needs to come to an agreement regarding auditing with every single customer. The benefit for the small companies in this aspect is greater than the extra work for the banks according to Thorell and Norberg (2005b) since it will lead to lower costs for the firms if they can voluntarily choose auditing when they feel the need for it, e.g. to receive a credit.

The main interest regarding compulsory audited financial statements for small corporations is held by the owners and the board, customers, suppliers, society and different sorts of creditors such as banks. (Andersson, 2005) In this thesis the authors have chosen to focus on the banks as creditors and investigate how this actor will be affected by a possible abolishment of the auditing duty.

3.2 Information collecting for credit rating

For a bank to perform a fair and valid assessment of a company's creditworthiness different types of information is needed. It is important that the information is correct and that it is correctly interpreted by the valuator. Different problems that might arise are discussed in the chapters below.

3.2.1 Skewed division of information

Research has shown that a market with a perfect information flow is not the reality; rather it exist a skewed information flow where the creditors and the credit applicants never have the same amount of information at the same time. It is also found that the probability that a credit applications is approved decreases with the size of the company, thus it is more difficult for a small firm than a large company to obtain a loan. (Svensson & Ulvenblad, 1994)

This trend is assumed to be caused by the greater risk which often follows smaller companies. This can in turn be associated with a skewed information flow. Without the right information the bank cannot approve the application. (Svensson & Ulvenblad, 1994) The skewed information flow is a result of the fact that a small company is often dependent on its leader/board which has access to all available information about the company, information that an external creditor does not possess. A skewed information flow is a greater problem for the creditor when it comes to smaller companies due to several reasons;

1. The cost of collecting information for a small company is relatively large since there are fewer transactions to gather.
2. The number of repeated transactions is low.
3. Due to a low demand, business and credit information agencies do not find it valuable to collect information for the smaller companies.

4. It is hard for the board of a small company to make its demands heard and to be perceived as reliable due to lack of connections. (Svensson & Ulvenblad, 1994)

The skewed information flow is causing problems for both the company and the creditor since the more skewed the information is the greater the risk becomes and thus creating an ineffective allocation of credits. Even though the creditor can give the applicant incentives to act in favour of both parties by writing contracts this is not an efficient strategy for the bank to get the advantage in terms of possessing all the important information due to lack of control. (Svensson, 2003)

3.2.2 Effective credit allocation

The obvious goal for a creditor is to have profitable clients and thus be able to rank the companies by risk and demand higher interest rates for the high risk clients. Banks compete for the clients both when it comes to credits and deposits. The unprofitable banks suffer from credit losses which in turn hit the part of the market with the worst opportunity to negotiate, which are the small companies. (Broomé et al., 1998)

Creditors want to achieve effective credit allocation where they strive to maximise the credits to the successful companies and minimise the credits to companies which go into bankruptcy and create credit losses for the banks. This attempt to create effective credit allocation during the credit rating process can according to Svensson & Ulvenblad (1994) be resembled by a hypotheses test which use the logic of type I- and type II-errors. According to this method type I-error exists when the bank rejects a credit application from a company that turns out to be a going concern, and the bank commits a type II-error when a credit is approved from a company which in time fails. After a while the bank performs a follow-up where the bank has an opportunity to adjust credits and end those that creates losses. During this follow-up process there is a risk for new errors, so called type III- and type IV-errors. The bank can now commit type III-errors when ending engagements with companies that later turns out to be a going concern, or keep a client that later fails in the future thus creating a type IV-error. (Svensson & Ulvenblad, 1994)

3.3 Corporate valuation

When valuing a company different aspects have to be taken into account. The most important decision that has to be made is which valuation method to use; this is made in order to find a fair value of the company. The easiest way might be to use the market value, but if the company is not listed that is not a possible solution. On the other hand it can be argued that it is not the most accurate way either. Shares are influenced by different external matters that do not have anything to do with the actual value of the company, and hence using the market value to measure the value of a company might lead to biased results. There are other ways to value a company which is based on calculations and forecasts instead, and they will be discussed in due course. (Frykman & Tolleryd, 2003)

3.3.1 Small company valuation

When valuing a small business different methods can be used. Since many of the small companies in Sweden are not listed it is not possible to value them in accordance with the market value they have. One solution to the problem is to compare the unlisted company with a listed company. When making this sort of comparison the assumption is made that for companies that in general have the same size, business area, gearing should have similar value. The point of using this method is to assume that for companies that fulfil the above

mentioned assumptions, the value of their shares should be similar. Using this argument it is claimed that if one company that is listed can be found it is possible to use the market value when valuing a company that is not listed. It can easily be understood that this method has some cons, starting with the possibility to find a company to compare with that is valid. (McLaney, 2003)

Some distinctions have to be explained in order to fully understand the different models and the underlying reason for choosing one specific model. The valuator must be aware of the difference between *equity value* and *entity value*. The former is concerned with the shareholders' claims to the company, and is also called market value. Equity value can be divided into the accounted for value and the market value. The entity value is the total value of the company, i.e. not only the shareholders but all the stakeholders. What differs the enterprise value from the equity value is that the former includes debt, minority interests etc. The next distinction that must be made is between the *fundamental* and *relative valuation*, which is two different ways of approaching valuation. Fundamental valuation is calculated based on the fundamentals of the company, which is concerned with valuing a company based on specific economic criterion. The latter of the two valuation methods uses chosen multiples to value the company. Examples of this are commonly used ratios for instance earnings per share or price/earnings ratio. Another important distinction that differ the two methods is that relative valuation is to a larger extent focused on different industries. As have been discussed earlier some problems are linked to using ratios as a measurement of a company. (Frykman & Tolleryd, 2003)

3.3.2 Valuation myths

Ygge (1996) stated some myths that commonly are associated with valuing a business. The first is of interest for the purpose of this thesis, and is that "The value of a closely held company is based on its "future" earnings." Ygge (p.2, 1996). What he wants to question is that discussions are often concerned with the fact that cash flows used in analyses are a prediction of the future and no one can be certain about how the future will turn out. His argument lies in that even if the cash flows are a prediction of the future, but the predictions are made using historical figures. Hence it is not really a prediction, which is important to take into consideration since it increases the validity of the analysis. (Ygge, 1996)

Another myth that is discussed by Kiholm Smith & Smith (2004) is "Beauty is in the eyes of the beholder", meaning that the value of a company might be biased depending on who is performing the valuation. The argument that it is hard to make a completely objective valuation is not unreasonable, but nowadays there are companies whose product/service is to perform an objective valuation. One example of this is UC. Added to this is that the professionals that value companies for investment purposes are highly skilled.

What the authors of this thesis want to stress with this discussion it to clarify the difficulties that are connected to choosing a specific method when valuing a company. This thesis investigates the problems that creditors will face when assessing a company's creditworthiness if the auditing duty is abolished. Many different organisations will be affected by this, and one of the most important businesses is the commercial banks. Ygge (1996) discussed the commercial banks as business valuers, and addresses the fact that one of the banks' most important strengths is their experience. In the cases when a commercial bank is involved in valuing a company in the role of being a credit grantor. For small companies it is rare that they are interested in the business plan, i.e. the product/service that the company provides. Instead they are interested in cash flow that the company expects to generate. The reason for this is that without any cash coming into the company its credit worthiness

is not enough since the company will not have something to support its repayments. (Ygge, 1996) Naturally a bank does not have the time or money to perform a valuation of every single company that is applying for a loan. Banks have to purchase the service from other organisations, and their job lies in the analysis of the information received. The difficulties faced by the banks are the balancing act they have to cope with having the scoring of the companies and the external factors from the environment that affects the company. (Ygge, 1996)

3.4 Credit Rating

The bank's first task when handling a credit application is to investigate if the candidate is creditworthy, thus perform a credit rating. This credit rating is based on the applicant's willingness and ability to repay the loan according to the contract and also an assessment of its collaterals. Policies, rules, routines and models used in the credit rating process to investigate the company's ability to repay are based on laws, regulations, recommendations and true and fair bank- and credit practices (Svensson, 2003). The models consist of different variables to be analysed and also a few demands that need to be fulfilled in order for the bank to accept the credit application. (Svensson & Ulvenblad, 1994)

The different variables mentioned can be categorised into five Cs;

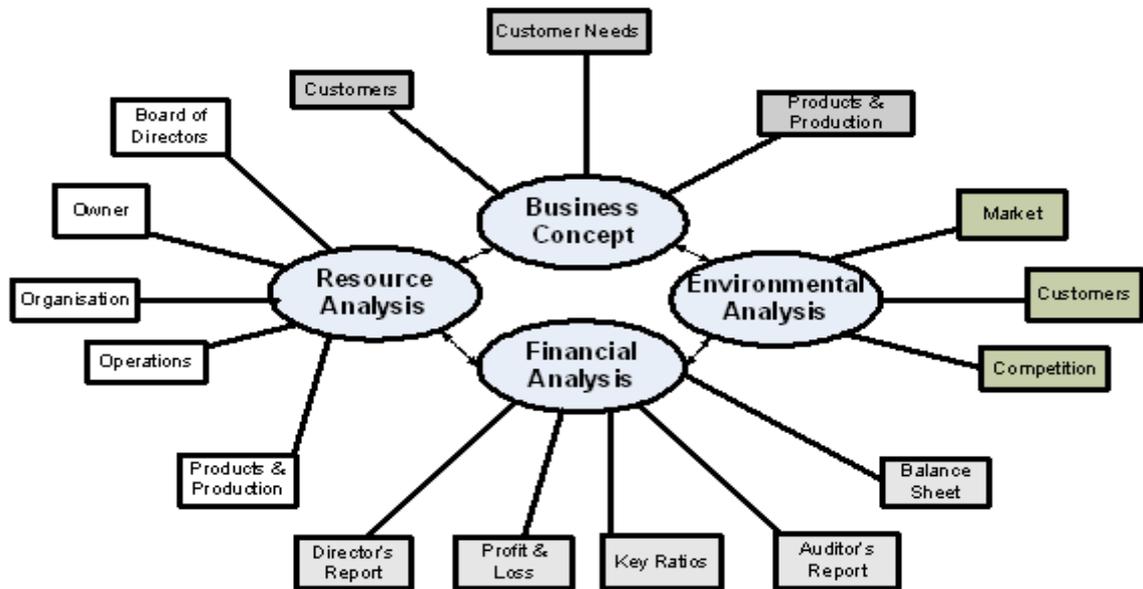
- Capacity: Ratios are used to determine the ability to repay.
- Character: The candidate is investigated in order to find his/her willingness to repay.
- Capital: The assets available in the company.
- Collateral: High risk companies may need to back up with collaterals.
- Condition: The situation around the world. (Svensson & Ulvenblad, 1994)

In order to be able to analyse the five Cs, information about the company needs to be gathered. Banks often use annual reports, period reports and budgets as well as credit reports ordered from professional business and credit information agencies. When rating companies connected with high risk, the banks are more interested in the information produced for their unique needs, including information from auditors. When it comes to collaterals the banks value these higher when rating small companies compared to large firms, and the banks do not want to bare the research and development costs for complementing accounting information. The level of reliability that the creditors can put on the annual reports depends on which auditor or auditing firm that the company hires. (Svensson, 2003)

Svedin (1992) set up a model that illustrates all the important aspect of analysing a company's creditworthiness. The four different areas that constitute the foundation of the model are;

1. **The business concept:** for the creditor it is important to value the company's growth potential and if the company possesses the knowledge to reach the goals.
2. **Environmental analysis:** an analysis of the environment where the company operates will enable the creditor to obtain an own view of the market and the company's growth potential within it.
3. **Financial analysis:** When analysing the company's annual reports and key ratios the creditor will find the company's financial situation.

4. **Resource analysis:** A company has different tools to work with and it is the creditor's task to see how valuable these resources are.



Source: Svedin (1992)

Figure 3-1 Model for analysing a company's creditworthiness

3.4.1 The financial analysis

As a consequence of an abolishment of the audit duty the most affected of the part of model 3-1 will be the financial analysis, and some parts of it will be discussed below. Copeland, Koller & Murrin (2000) addressed the importance that different financial indicators should be supplemented with the method when valuing a company. The authors of this thesis have chosen to discuss ratio based method with a discounted cash flow method. This since they are both valuation methods that will be affected of an abolishment but also since the can be used without accounted for figures as well.

A simple description of what ratio based valuation is would be to say that the value of the company is put in relation to specific features of its performance. When using ratios as part of company valuation it is of importance to only use companies that are in the same industry must be stressed. This since different industries have different ratios depending on for example expected growth. Using ratios have three main areas of use, and the *first* one is when comparing different companies. This can not only be used when valuing the actual company, but also to analyse expectations that the market have of the company. Good results are often reached when comparing companies' different years' ratios, since it will give a broader base to analyse. The *second* area is a general picture of the company's historical performance. This cannot only be used to analyse the company itself but also who it has coped with business cycles and to see if it has faced any other difficulties that has affected the accounting figures of the company. The *third* and last way to use a ratio is to use is and compare it to the market. The most common way of this is when analysing whether a stock is valued at a fairly correct market price. This is often used by investors and an unevaluated stock can be seen as a warning sign to a bad investment. (Frykman & Tolleryd, 2003)

All methods using a predicted future cash flow is called *economic value*. It can be seen as the most logical alternative, but it is connected with difficulties. This method is based solely on

the previous cash flows when estimating the future, and predicting cash flows is seen as difficult. Combined with that, a suitable discount rate needs to be identified in order to use the method. (McLaney, 2003) Discounted cash flows assume that the company is going concern and is not used for financial instruments. It cannot either be used for specific industries, but are solely for companies. (Frykman & Tolleryd, 2003)

3.4.2 Basel II

Basel II, *revised international capital framework*, is the second of the Basel Accords presenting recommendations on laws and regulations for banks. The amended accord are made to give the companies more options when calculating the capital cover that is needed to cope with credit risk, market risk and operational risk that the companies will face. Basel II is to generate a system that will easily view the risks of a business, and the information is to be published on a regular basis. (Bredhe, 2007)

The accord consists of three pillars;

1. minimum capital requirement, which deals with preservation of regulatory capital calculations for the three risk factors.
2. supervisory committee, which deals with the regulatory response to the first pillar as well as dealing with the added risk that the bank might face.
3. market discipline, deals with the increase in disclosure that the bank is facing. The major reason for this pillar is to give a better picture to the market of the bank's risk position.

(Markt/2515/06)

In Nordea's annual report from 2006 probable effects for the company is discussed. It is stated that it is likely that the effects of the accord will have a stepwise effect on the bank. (Nordea, 2007b) This is due to the Basel II floors that limit a possible decrease of the capital requirement. Other effects for banks' as creditors to small and medium sized enterprises (SMEs) are discussed in a survey presented by www.sme-basel2.com. The result does not indicate any rapid changes, and neither any significant change for the banks. There are though some concerns and a clear demand for more information and direction. (www.sme-basel2.com)

4 Empirical findings

In this chapter the empirical findings collected from the interviews with FAR SRS, Företagarna, Handelsbanken, Nordea, and Upplysningscentralen (UC) are presented. The information is structured similar to the interview guides and the answers are presented in terms of the name of the organisation instead of the names of the specific respondent. With this approach the authors wanted to create a better flow in the text. The respondent for each organisation are presented in chapter two.

4.1 The audit duty

As the audit duty for the small and medium sized companies are about to be abolished, the authors thought it was of interest to find out what the different perceptions of the audit duty and its value were. Further the authors tried to find answers to what changes that would come with an abolishment of the audit duty and what complementing control system that might be needed.

4.1.1 Value of the audit duty

Both Nordea and Handelsbanken (L. Francke, personal communication, 2007-05-03) thought that the audit duty has a value attached to it. The two banks as well as UC (M. Eklund & M. Jonsson, personal communication, 2007-04-26) saw the reliability and comparability of the financial reports as important aspects that are influenced by auditing. Further Nordea believed that the bank will continue to demand audited reports even though the duty disappears since auditing act as an important tool during the credit rating process. (P. Svenningsson, personal communication, 2007-04-23)

Handelsbanken explained that auditing is particularly valuable at times when a company suffers from financial stress, however an auditor can also act as a complement to the bank giving support and advices in order to find suitable financial solutions. On the other hand, Handelsbanken could also understand that auditing is not a necessity for the smallest companies and the bank realises that an abolishment of the audit duty will lead to a decrease of costs for the companies. From Handelsbanken's view they are of the opinion that for its corporate clients with the smallest enterprises the simplification will be positive, and thus also have a positive effect for Handelsbanken. (L. Francke, personal communication, 2007-05-03)

UC (M. Eklund & M. Jonsson, personal communication, 2007-04-26) together with FAR SRS stated that auditing proves a certain quality of the financial reports. According to FAR SRS the audit duty enables the market to operate without even questioning the quality of the financial reports. This is an important aspect of the duty that the market takes for granted. The audit duty is also a mean for counteracting cheating and without the duty the security disappears. (B. Skough, personal communication, 2007-04-25)

Företagarna believes that there is no need for an audit duty for small and medium sized companies. Even though there is some value attached to auditing it does not mean a great value to all companies. Some will probably continue to publish audited reports even without the duty, however according to Företagarna it is the development of simplifying the regulations for the small and medium sized companies that is important. For the members of Företagarna, the audit duty is perceived as difficult and annoying, according to a member survey made in the turn of the year 2006/2007. In this survey Företagarna questioned which rule or regulation that was perceived as the most annoying and auditing came second. (A. Fritsch, personal communication, 2007-04-26)

4.1.2 Changes as a result of an abolishment of the audit duty

Nordea believes that there will not be great changes caused by the abolishment of the audit duty seen from the bank's point of view. Nordea sees a need for auditing in the future as well, but stresses that it is more important to act and behave according to the Basel II recommendations. If there is an exemption of the audit duty the relation between the bank and the credit applicant will play a role in where the trust of the owners and the board affects the reliability of the figures. Collaterals and other demands from the market will be important. However, Nordea cannot see any specific changes to its clientele as a result of an abolishment of the audit duty. (P. Svenningsson, personal communication, 2007-04-23)

Handelsbanken also stresses the close contact between the bank and its credit applicant, and the trust that exists between the two parties.

“A long-term customer relationship is an important part of our general customer philosophy in Handelsbanken. It is emphasised by our strongly decentralised organisation and that the customer- and credit responsibility for all customer, large as well as small, lies on the local branch.” (L. Francke, personal communication, 2007-05-03)

It is in sensitive situations where the bank does not have enough trust for the owner where an auditor can play the role as an important intermediary which can result in more satisfying financial solutions for both the company and the bank.

Handelsbanken cannot see that an abolishment of the audit duty will result in a change of its clientele. For other countries which have already established an audit exempt for small and medium sized companies, it is a fact that many companies still use auditing in the same way as before the abolishment. In many cases the reason for using auditing is due to an agreement with the bank, which has the power to demand auditing even without the duty. (L. Francke, personal communication, 2007-05-03)

On the contrary, Företagarna can see situations in the future where the smallest companies turn to their family for financial support instead of to their bank if the bank requires audited reports. The cost of auditing can be a burden for the smallest companies and if they need help with their bookkeeping they turn to an accountant instead. In many cases the contact between the company and the auditor is nonexistent, and instead the communication goes from the company to an accountant and from the accountant to the auditor. Due to the lack of contact between the company and the auditor the company may not be able to see the value of the auditor and that its expertise is worth the cost. Företagarna would like to see a greater cooperation between the auditors and the companies and to find the modern way to control the accounts. (A. Fritsch, personal communication, 2007-04-26)

FAR SRS can also see the problems with a lack of communication between the company and the auditor. According to the Swedish generally accepted auditing standards, an auditor has to meet with its customers physically at least once a year; if this is not done the obligations under the Swedish generally accepted auditing standards are not met. For some auditors the time is scarce and due to this the only party that the company meets is the accountant that deals with the ongoing bookkeeping. The auditor only meets with the accountant at the end of the financial year when signing the auditor's report. This fact can be of great problem for this particular auditor if the audit duty is abolished. If the Swedish generally accepted auditing standards are not met the relationship with the customer suffers and it is likely that the auditor loses several customers. (B. Skough, personal communication, 2007-04-25)

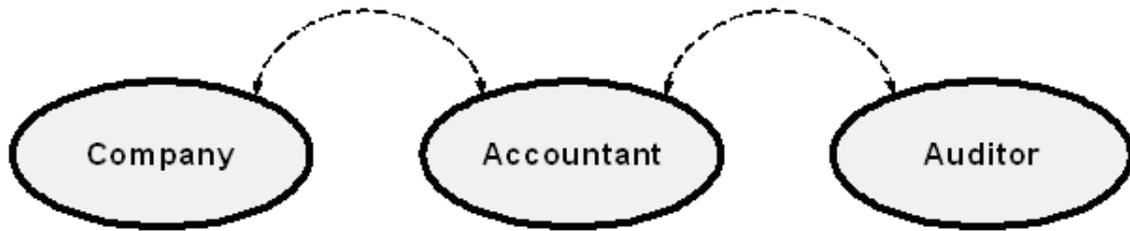


Figure 4-1 The relationship between the customer and the auditor.

At FAR SRS one can see other problems resulting from an abolishment of the audit duty. The auditor's role will be different if the audit duty disappears. There will be a development towards more coaching and consulting and less focus on the auditing. This can lead to that in the future there will be a lack of auditors. The scarcity of auditors can also be caused by the fact that approximately half of the staff is over 50 years old and several of them might decide to retire prior to the abolishment of the audit duty. (B. Skough, personal communication, 2007-04-25)

UC do not think that its clientele will be different after an abolishment of the audit duty. The banks can still rely on its products since UC already has proven that it works to make a reliable analysis of a company without audited financial reports. UC has been a supplier of information regarding other company formations apart from the ones that need audited accounts. However UC has to take into consideration that they are working with different material; unaudited and audited reports, and its customers using a product from such analysis need to know under which condition the analysis is built upon. (M. Eklund & M. Jons-son, personal communication, 2007-04-26)

4.1.3 A complementing control system

Företagarna sees several possibilities and few problems with an audit exempt. There will be a period during the transition phase where there will be some uncertainty. A need for a new control system may develop but it is important that the market agrees on one single system. There are other alternatives to auditing since other company formations have received credits at all times. The tax authority also has a great interest in this subject and it is a fact that this authority can track cheating before the auditors manage to find them. The question still remains on how to do that, but one suggestion is to look at the foregoers such as England. (A. Fritsch, personal communication, 2007-04-26)

FAR SRS refers to an article in "Nytt från revisorn" (Wennberg, 2007) where Bengt Skough has answered questions regarding the audit exempt for small and medium sized companies and if there is a need for a new control system. Skough believes that it is up to the market to find the solution if another control system will be needed. However, there is a probability that the tax authority will increase its controls of the affected companies if the audit duty is abolished. FAR SRS has discussed with UC the possibility of introducing a so called "R"- label where R stands for the Swedish word for auditing (reviderad). For the companies that continue using auditing the R-label will give value added and be a part of the company name. (Wennberg, 2007)

Handelsbanken points at the foregoers in Great Britain which has developed an alternative to the audit duty for the small and medium sized companies. A company can use the help of a consultant, which has passed a certain quality test, to establish its closure of financial

reports. If so, this will be held clear in the annual report. Handelsbanken believes that an alternative similar to the one in Great Britain could be considered also in Sweden. (L. Francke, personal communication, 2007-05-03)

4.2 Information collection for credit rating

During the process of credit rating, a creditor needs different types of information in order to analyse if a company is creditworthy. The authors were interested in what kind of changes an abolishment of the audit duty can cause to the information collection. Since the audit has been seen as a quality control, the authors also wanted to see if the respondents anticipated a decrease of the financial reports' value due to an abolishment of the duty.

4.2.1 Changes to the process of collecting information

Nordea sees audited annual reports as an important part of the collected information and the perception is that Nordea will continue demanding audited accounts, thus does not expect any specific changes to the process of information collection. However the audited accounts are not the only information source the bank uses during the credit rating, Nordea believes that since the figures in the financial statement in the annual report are historical, it is also important to take into account what has happened after these financial reports. From Nordea's point of view a creditor uses and compares the historical figures with future figures and here the comparability aspect is important. Economic forecasts and budgets are never audited but these are interesting since they show forward directed information and the bank analyse if the company can follow the direction as well as the purpose of the budget. (P. Svenningsson, personal communication, 2007-04-23)

According to FAR SRS the banks have in general an incorrect attitude towards the historical figures in financial reports. These figures are seen as too old and that the auditor's report is not up to date. FAR SRS say that this is wrong since when the banks are making generalisations that annual reports consists of historical data, it is important that the banks consider that auditing is also a quality control of the accounting system that are used when producing up-to-date reports. (B. Skough, personal communication, 2007-04-25)

Also Företagarna realises that the members who take advantage of the audit exempt will need to show complementing information to prove the value of their company. If the entrepreneur him/herself does not possess the knowledge in specific areas, s/he can hire someone who does. Företagarna believes that it will be a greater demand for coaching and consulting, which is what the auditors should focus on in the future. However, Företagarna does not see a great problem with not having audited reports since the banks in general need more up to date information than the annual report can give. (A. Fritsch, personal communication, 2007-04-26)

For UC who looks at both audited accounts and unaudited accounts believes that some degree of uncertainty with the accounts that are not audited will exist. UC has to believe that the information from the companies is true. UC analyses all information that an annual report presents. The company is not only using the financial reports thus also looks at the board of directors and what kind of commitments the company has been involved in during the previously. Special value is put on the auditor's report as this will give the reader supplementing information that the financial report cannot give. One can also by reading the auditor's report thoroughly, get a sense of the financial climate the company is operation under. According to UC the figures are important but not the most important aspect. (M. Eklund & M. Jonsson, personal communication, 2007-04-26)

4.2.2 Reliability of unaudited financial reports

When it comes to the reliability of the collected information, Nordea values audited accounts high although the auditor also is viewed through a critical lens. Nordea mentioned other methods to be used as well such as comparing the figures with similar companies within the same industry, and then one can detect deviant figures. The creditor also analyses the reliability of the owner and the board. The competence of the bank's employee has a role when it comes to estimating the reliability of a company's financial reports. (P. Svenningsson, personal communication, 2007-04-23)

Handelsbanken stated that if a company's financial reports are not audited, the guarantee of the quality must be found elsewhere. Thus there is a shift of focus towards the reliability that the owner of the company possesses instead. It is of great importance that the bank and its customer have a close and continuous relationship built on trust. In the end a decision is built upon the knowledge that the bank has gained through these meetings and discussions with the customer. (L. Francke, personal communication, 2007-05-03)

FAR SRS believes that the quality of the small and medium sized companies' financial reports will decrease without auditing. Amendments with the mission of simplify for these companies will lead to new regulations to learn and in general the auditors know the rules better than the accountants. (B. Skough, personal communication, 2007-04-25)

4.3 Company valuation

The valuation of a company according to Nordea is not only based on the financial situation that the company is in today, but it is also of interest what the company will be able to generate in the future. It might feel quite naturally but its importance must be stressed, since it is after all in the future the company are to repay its debts. Connected to this is valuing the company's earnings capacity as an important part of the valuation. For the overall valuation Nordea is using traditional valuation methods, but during special circumstances some alternative models can be used. This is for example used when valuing intangible assets. (P. Svenningsson, personal communication, 2007-04-23)

4.4 Credit Rating

According to Nordea the process of credit rating has developed and there are some obvious differences today compared to the credit rating process twenty years ago. Today the bank has recommendations to follow under Basel II. The methods used in the credit rating process are also different today where for example the cash flow analysis is frequently used as well as key ratios. The choice of ratios has during the last couple of years grown in importance. Focus is now more and more on ratios that are not only valuing the solidity, but on ratios that changes more easily. What is meant by this is that when using a ratio that is based on a company's solidity it will not be as quickly changed since it is a valuation which is a prediction on a long time frame. If one on the other hand compared interest-bearing debts in relation to earnings before interest tax depreciation and amortisation (EBITDA) changes will be found earlier. Added to this Nordea also stresses the importance of having in mind that the annual reports consist of accounted for figures. With that aspect in mind it does not matter what type of ratios that are used, one still have to have in mind that the figures cannot be completely trusted. Nordea uses ratios mainly as a measurement to compare companies to each other as well as with an industry average. (P. Svenningsson, personal communication, 2007-04-23)

Handelsbanken explains that the methods used when performing a credit rating are the same as what is presented in the literature in this specific subject. What is a possible difference in Handelsbanken's approach compared to other banks is that the focus is less number oriented and more directed towards the knowledge on the companies' operations as a whole and their financial strengths. This is mainly due to the decentralised company policy that they have. (L. Francke, personal communication, 2007-05-03)

5 Analysis

In this chapter the analysis of the thesis is presented. It is divided into two parts, where the first is an in depth analysis of the respondents and the second part contains the four areas of interests which has been discusses throughout the thesis.

5.1 Analysis of the interviewees

The structure of the analysis will differ from the structure of the previous two chapters. It will consist of an analysis of the different interviewees followed by an analysis of their view of the changes that will be caused by a possible abolishment of the audit duty. The structure of the companies will be the same as they are presented in the method chapter.

The reason for changing the structure in the analysis chapter was made by the authors since a need could be seen to analyse the companies' view of the four topics addressed. Without the company analysis it would not have been possible to later make an analysis of the differences that occurred between the companies in the four areas of interests for the thesis.

5.1.1 FAR SRS

For the purpose of this thesis the contribution from FAR SRS lies in the aspect of analysing how they predict the validity of the financial statements will be affected, i.e. will the companies' reports be trustworthy even if they are not audited. In the empirical chapter the relationship between the company and the auditor is addressed by FAR SRS and they claim that the relation could to a great extent be developed. Imagine a company that does not have a good relationship with its auditor, and might even only see the auditor as someone that puts a signature on the annual report charging a high fee for a small effort made. This addresses the importance of understanding what the auditing contributes with. FAR SRS also stresses the quality factor which probably will be a big concern if the audit duty is abolished. Since audited reports do not only state that the accounts are correct, but also that the ongoing reporting is performed in accordance with generally accepted auditing standards. Hence, not having audited reports will not only open discussions regarding the annual report but the ongoing reporting as well.

FAR SRS also addresses one commonly discussed issue concerning company valuation which is the significance of historical figures. FAR SRS's opinion that a tendency for valuers to underestimate the importance of historical figures exists confirms Ygge's (1996) view of the myth. Ygge (1996) claims that there is a strong relation between historical, present and future figures. What will then happen in the future when the historical figures cannot be trusted to be correct? How will it be possible to predict future cash flows to state that a company actually will have an income stream if one cannot trust the figures that the prediction is based on? In this aspect a possible abolishment of the audit duty will cause big concerns for the valuers.

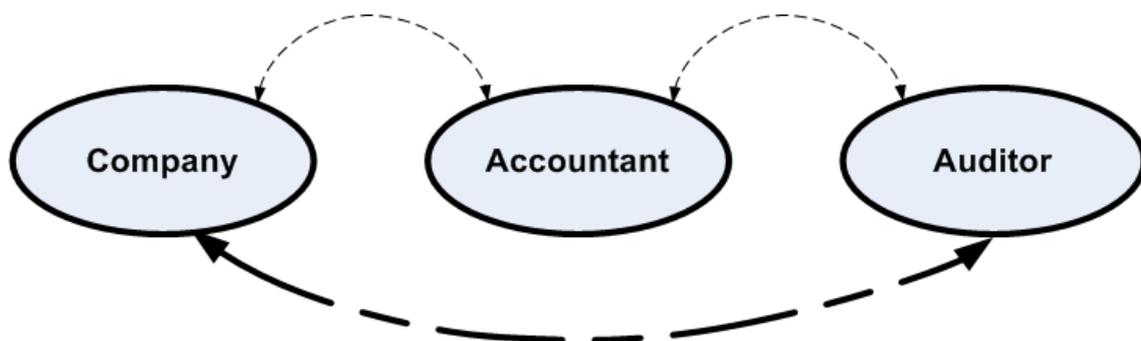


Figure 5-1 The relationship with the accountant as a coach

If the audit duty would be abolished FAR SRS believes in a change in the auditor's role. They predict that it will go towards a more consulting and coaching task. Model 4-1 describes the current relation between the company and its auditor, and with the changes the model would have an arrow going from the company and straight to the auditor as in figure 5-1. This would probably generate a greater knowledge of the company for the auditor. Although it is just a well founded guess by FAR SRS it does seem as a good idea. By having good knowledge of a company the auditors might be able to give some added value to the company in a valuation process. The biggest concern for the creditors if the audit duty would be abolished is that they cannot to the same extent trust the financial statements produced by a company. If the auditor has a good knowledge of the company's ongoing accounting as well as the annual report the auditors' role could work as insurance that the company's finances can be trusted. This might rule out some of what Svensson & Ulvenblad (1994) state as type I-errors, since the information available to the bank increases and thus becomes more valid.

5.1.2 Företagarna

Företagarna claims that its members see no need for having audited financial statements and the value that it adds to the company is not of importance. They see it is as more important with simplifying the situation for the companies. Thorell and Norberg (2005b) stated that seen from the banks' view having audited financial statements is more a question of convenience than a necessity, which without any doubt strengthens Företagarna's view. Even though one can see a point in its opinions it is after all the banks that decides to whom they want to give credit, which could end the discussion quite fast but it does not. It is a fact that the government that appointed the investigation has had as a strong argument in its propaganda to ease the situation for small companies. This will most likely end as a consequence of an abolishment, which will force the banks to rethink the convenience factor and a compromise have to be developed.

Företagarna believes in a new system replacing audited annual reports, but think it should be developed based on the demands from the industry. How a system would look is hard to predict, but the authors of this thesis would like to stress the need for a system that rules out all the different type of errors that is addressed by Svensson & Ulvenblad (1994). Meaning that the banks would not give credit to companies that are not creditworthy and companies that are creditworthy would not be turned down, i.e. no form of adverse selection would occur. Having a system with as low rate of errors as possible would be in favour of both creditors (banks) as well as companies, since it would decrease the rate of bad debt and hopefully all companies that are creditworthy are given credits in line with their ability to repay.

Företagarna's members can seek funding by turning to family and friends, which will diminish its need for a new system to be developed. This argument would most likely only work for a fairly small amount of money and probably only fit the smallest companies. This scenario would probably only work if the threshold values that determine which companies that will go under the audit exempt, are set quite low to a beginning. This is a system that worked well in England, where they started with low threshold values but have continually increased the levels and now have values corresponding to the EU maximum. It might even be a good idea for Sweden to follow the English case to develop the limits depending on the success of the change that an abolishment will cause. One matter has to be taken into consideration first though and that is the business climate. This does not only concern in particular the English case (Thorell & Norberg, 2005b), but the Danish (Aggestam Ponttopidan, 2007) and the Finnish (RP 194/2006 rd) as well. Finland has chosen to set fairly low levels, and this might also be a good idea for Sweden to start with as well. Having this as a starting off point the authors consider following England as a good idea, doing follow ups on the matter and increasing the levels if it is working well. This seems as the most appropriate way to handle the matter for the Swedes.

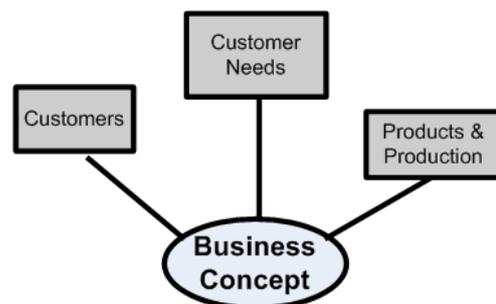
Totally ruling out the banks as creditors for certain companies, as Företagarna see as a solution, might be going to an extreme, and the authors of this thesis would like to stress that some sort of new system is needed in order to reach a compromise that fits everyone involved in the process. Having a developed system is a necessity in order to have a base for the banks to use when valuing a company in a credit process. Exactly how a system would look like is impossible to predict, but that it adds value to the company in a way that is a benefit for the banks as well.

5.1.3 Handelsbanken (SHB)

SHB believes in positive effects for both the company and the bank with an abolishment of the audit, but the valuation will still be affected. According to SHB having audited financial statements is a benefit when a company is in financial stress. What will then happen if the audit duty is abolished? The authors of this thesis consider the model by Svedin (1992) to be a good evaluation method for analysing a company's different strengths when valuing if it is creditworthy. It is interesting in the SHB's case since the bank has a decentralised way of working which means that they are not primarily focusing on the financial part of the analysis but value the other bits high as well. This can be done since they have a broad knowledge of the other parts representing in the model by Svedin (1992). They will each be analysed in the part below.

Figure 5-2 Business Concept

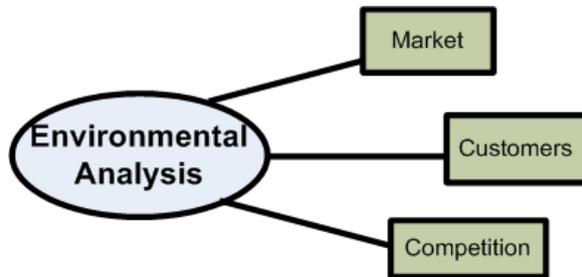
Starting with the *Business Concept* it is likely that SHB can understand the growth potential of a company and by knowing the company it is also possible for SHB to estimate whether it is possible for the company to reach its goals. SHB stresses the importance of a continuous contact with its clients and this will most likely increase the bank's knowledge of the company. Since most of the decision making is done on the branch, SHB's valuation is to a high degree based on the knowledge of the company, which is possible only if the bank and the company have a good relationship. Without a close relationship and a good knowledge about the company analysing the business



concept would generate difficulties. Having knowledge of the supply and demand situation that a company is working under and analysing according to this is a disadvantage since it will increase the possibility to make evaluation of the estimated future earnings. In SHB's case this is probably well established in the process since they are already using a decentralised way of valuation a company's creditworthiness. An abolishment of the audit duty would probably not have a huge impact of this part in SHB's case since they are already having a good understanding of the area.

Figure 5-3 Environmental Analysis

The second part of the model to be discussed is the *Environmental Analysis*. This part of the model is quite closely related to the business concept but see the company more from the outside perspective, focusing on the market instead of the production. This is probably the



area where less change will occur due to an abolishment of the audit duty. Deep understanding of the business climate in the area is a must for a bank. No matter how centralised the organisation is the bank have to be aware of the different players and the competition that is on the market. By this the authors does not mean that the environmental analysis is not important when valuing a company, but rather the opposite. It is such an important factor that it will not be affected by an abolishment since it is an important cog in the process itself. What can be argued is on the other hand that for small companies the surrounding environment is more important than for larger companies since small companies have fewer resources to compete with.

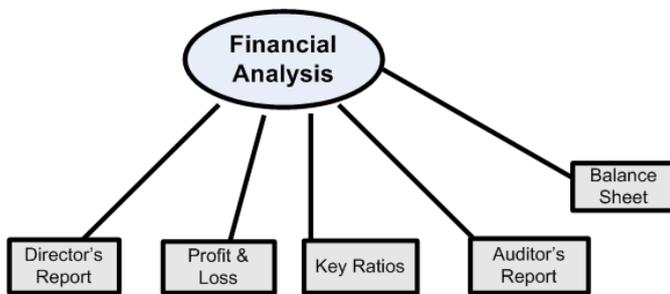


Figure 5-4 Financial Analysis

Next part that will be addressed is the *Financial Analysis*, which is the part where the authors predict the biggest change will be seen for SHB with a possible abolishment of the audit duty. Important to

remember though in the SHB case is that they are not focusing solely on figures. This will probably make the change less important than for banks that are more centralised and also have less developed systems for using other types of information to value a company. As an overall discussion one aspect is interesting with the SHB case, which is that the bank claims that audited accounts are most important when estimating a company's creditworthiness when the company is in financial stress. This gives an indication that SHB is valuing the financial analysis when the other analyses cannot be fully trusted. Is an abolishment then not taking away the most valuable tool? They say that the audit duty is valuable, but at the same time that SHB's decentralised organisation values other important parts as well. SHB also argue that for the small companies that see an abolishment as something positive it is also positive for the bank. But this is only true if the companies are transparent in how it is operating. This seems a bit confusing since it basically says that only if the company is

easy to value the abolishment is positive. Can one then not conclude that SHB will face major problems valuing companies that are not transparent if the audit duty is abolished? It is also most likely that it is in that process the errors stated by Svensson & Ulvenblad (1994) will occur.

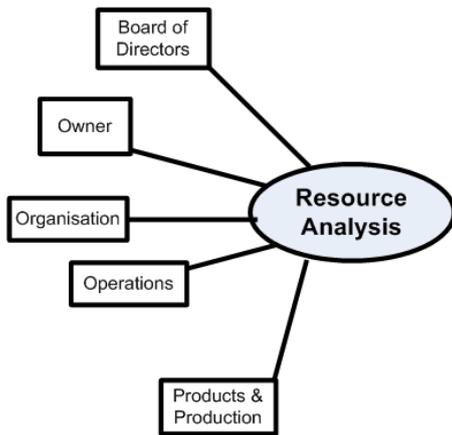


Figure 5-5 Resource Analysis

The last part of the model is the *Resource analysis*. This part concerns resources that add value, but are not assets. Valuing this part the continuous contact that SHB have with its clients is an important aspect. The knowledge that the bank possesses of a company's management by having a close relationship with them will once again be of SHB's advantage. If the audit duty is abolished this would, as have been discussed earlier, not only question the actual annual reports but the ongoing book-

keeping too. If the bank on the other hand have good knowledge of the management and by that could to some extent claim to have a trust in the financial situation that the company is operating within, the problem could be diminished. One can certainly say that even from this view SHB gains substantially from having a good relationship with its clients. Whether it is enough to straighten the question marks that the audit duty will create is yet to see.

5.1.4 Nordea

Nordea differs from SHB in the way that it is more centralised and thus the valuation of a company's creditworthiness differs. Nordea is a large banking group and in order to make all the different parts work it is important that all the different branches and departments work in the same way. One example of this is that in order to fulfil the criterion set by Basel II the branches must have the regulation in mind during the credit process.

Although the employees are working in a huge organisation the competence and trust of the employees is seen as an important cog in the process. This is discussed by Ygge (1996) as well where he claims that the bank and its employees posses a strength in the valuation process in their experience. This is also connected to Kiholm Smith & Smith's (2004) discussion on the valuation process. They argue that the myth "beauty is in the eyes of the beholder" is not applicable on today's large valuers, since they have good tools in forms of computer programs and that the industry is more transparent today due to the information technology available. These two arguments are important in Nordea's case since if the employees want to approve a credit application that is not approved according the system it puts high pressure on the employees' competence in not making the wrong decision.

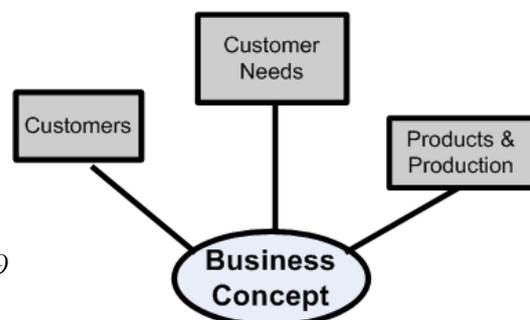


Figure 5-6 Business Concept

Nordea will, in the same manner as SHB, be analysed using the Svedin (1992) model. Starting with the *Business Concept* this is concerned with the inside-out perspective of the company. Not meaning that Nordea have an incorrect knowledge of the company at the moment, this is probably a part of the valuation process where Nordea could gain by developing further if the audit duty is abolished. Having a deep knowledge about a business's operations gives a chance to make a more advanced analysis on the company's future. An example of this is having knowledge about future developments. Connecting this to information about the company's customer needs would increase the ability to make a fair valuation of the company. This can be connected to Ygge's (1996) discussion of the employees' experience and the authors see no problem in the process, but would like to stress its importance.

Figure 5-7 Environmental Analysis

The next part from the model to be evaluated is the *Environmental analysis*. This part will probably not need that much development for Nordea. Having a broad knowledge of the business climate is a must for a bank, and an abolishment of the audit duty is not likely to develop this any further. On the other hand is this part of the model closely connected to the business concept, and if the bank would develop that part further it is likely that the environment analysis would be affected as well. By this the authors mean that evaluating the environmental analysis might be easier if a deep understanding of the business concept can be connected to it. Further the arguments of the competitive environment that are addressed in the SHB discussion can be applied to Nordea as well.

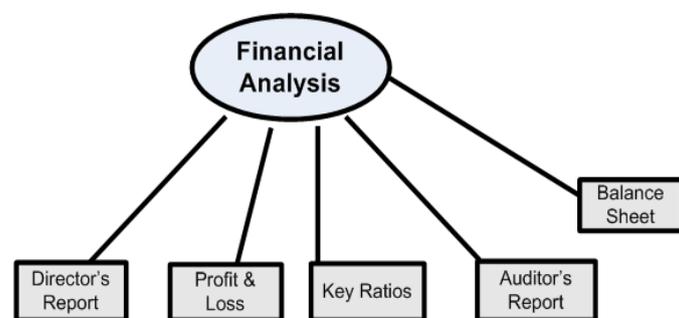
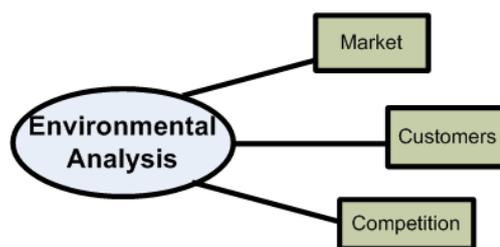


Figure 5-8 Financial Analysis

The upcoming part is the *financial analysis* and the authors see some differences in how the two banks in this study will be affected by an abolishment of the audit duty in this area. Nordea sees a great value in using audited financial statements, and predict that they will keep demanding audited financial statements even in the future. The bank is more figure focused than SHB, and if the value of the figure will decrease alternative measurements need to be developed. On the other hand Nordea argues that they are to a large extent focused on forecasting future earnings, which are not audited figures and by that the implication of the abolishment will be diminished. Whether this is true or not can be discussed. Having audited financial statements does not only mean that the annual reports have passed the quality control but also that the ongoing bookkeeping is correct. This means that when using historical figures to predict the future one should be able to trust that the future figures will be correct too, hence one could say that the predicted future figures are audited. On the other hand it is a pro if Nordea does not consider the abolishment as a problem in the areas where most of the energy is put during the valuation process. As a complement to the predicted future earnings Nordea

uses different ratios, including both fundamental and relative multiples. Ratios are a good complement to cash flow estimations, and this is a major advantage in Nordeas case since it will further strengthen the analysis. Naturally the ratios will be affected by an abolishment of the audit duty since all the financial data used for calculating the ratios is gathered from annual reports.

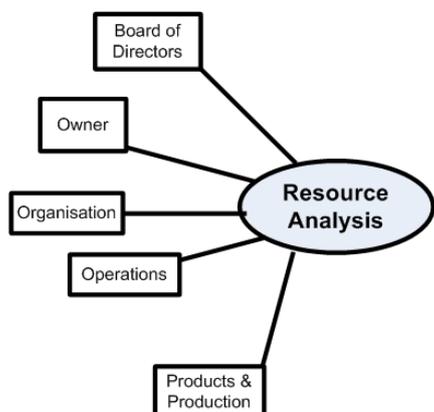


Figure 5-9 Resource Analysis

The last part of the model is the *Resource Analysis*. This is also a part where a good relationship would be beneficial for both the company and the bank since it will generate an understanding of the company's management. With a probable abolishment of the audit duty a relationship that is to a larger extent built on trust would be a definite pro. This would be an advantage for Nordea since it is a more centralised organisation and to have the added value of

good information on the management adds value to other parts. For example it might generate valuable information about the business concept, which will add value even to the environmental analysis. The resource analysis combined with the business concept is where Nordea probably will have to develop most. It does not mean that the bank is bad in these areas rather that it is where development can be made to cover the somewhat negative changes that an abolishment of the audit duty probably will generate.

5.1.5 UC

The primary role of UC seen from the banks perspective is to supply analyses of the financial climate of a company. The analysis generates a risk classification, a risk prognosis and a maximum credit limit. Added to the report is also whether the company has any record of non-payments. This seems as a fairly objective way of analysing a company, and that is probably the reason why companies value UC's product high. It can be seen as a security, which makes it possible for the banks to have less pressure on its own valuation. No doubt that this connection can be made with what Thorell and Norberg (2005b) are discussing when they say that having audited financial statements is a convenience factor for the banks. UC does not see a problem in not having audited financial statements arguing that they perform analyses on companies today that does not have audited financial statements. Even though UC will still be producing the prognosis and they claim that there will be no difference in their product, it must still be argued that some sort of decrease in the security will be an effect since it after all is no longer based on audited figures.

To UC's defence is the earlier discussed English case (Thorell & Norberg, 2005b). They have managed to develop a well working system and so UC might not be that far off saying that the difference in its product will not be significant. UC did state that they are aware of the value that is added when having audited financial statements. One does also have to have in mind that UC's product is to analysing companies and if it after an abolishment will turn out to be less accurate than before some sort of amendment will probably solve the problem. It is after all not likely that the company will operate selling a product that is not reliable.

Banks are at the moment taking for granted that the product bought from UC will be based on audited financial statements. The question that will arise with an abolishment is proba-

bly not whether the banks will still be purchasing the product, but rather to what extent they are willing to trust its value. Most likely the product will not generate the same security that it did before, but as UC argues the product is not solely based on annual reports. The banks will most likely have to take a larger responsibility in the valuing process, making sure that the total analysis is showing a fair view of the company's financial situation.

5.2 The audit duty

Analysing the different companies' opinion the authors could see some distinct differences. This does not mean that any of the companies does not see a value in having audited financial statements, but rather that they have different opinions about the value it gives small companies. The authors have developed a figure displaying how high the companies are valuing audited financial statements.



Figure 5-10 The value of the audit duty according to the interviewees

Starting at the companies that are most in favour of having audited financial statements is FAR SRS, which might not be a total surprise since they are the auditors' trade association. From the authors view FAR SRS's most important argument in favour of the audit duty was that having audited financial statement assures a certain security for the ongoing bookkeeping. This aspect was not addressed by any of the other respondents of this thesis and the authors would like to stress its importance, since the ongoing bookkeeping after all is the foundation to properly prepared annual reports.

Second in line of favouring audited financial statements is Nordea. The authors chose to put Nordea at this spot on the line due to the bank's believe that they will demand audited financial statements even if the duty is abolished. The bank does have additional factors during the process of assessing a company's creditworthiness, but value the quality of factor that auditing generates high.

Next on the line is UC and even though they do not see any major problem in its product as a result of an abolishment they are of the opinion that the reliability and validity of the statements are important. Thus an abolishment of the audit duty will most likely affect the quality of the financial statements. The authors would in this case like to address the fact that if one of the factors of the valuation made by UC is changed it is difficult not to see a change in the product. This does not mean that the product is not as valid or reliable in the future, but a change is hard not anticipating.

SHB is set as second last on the line since they do not seem to see any particular problems with an abolishment. This does not mean that they do not see a value in the auditing, but that the influence it has on the credit process in the bank is not of determining value. SHB is a decentralised organisation, which makes it possible for the bank to value a company according to the business environment more than a company that is more centralised such as Nordea. This since the bank does not have the same common rules and regulations that more centralised organisations have.

The organisation least in favour of the audit duty is Företagarna. Företagarna is a trade organisation for SME's, and to say that they are least in favour is probably an understatement and the truth is probably that they are against audited financial statements. They see it as a

problem and something negative. It is not difficult to understand that they see it as an expense, but on the other hand it is for example used by banks as one of the valuation criteria to assess creditworthiness. The reason why banks are using it is to make a fair valuation of a company, and that is after all in the interest of the companies as well since it decreases the possibility of errors made.

5.3 Information for credit collecting

Out of the five respondents in this study the three, which are not banks, are chosen since the information that they contribute with will most likely influence a bank's valuation of a company's creditworthiness. How they will be affected has been presented above and this part will discuss the implication that they as a group will have on the information flow given to the banks for making a fair credit process.

When a bank is valuing a company as part of the credit process it has an internal process that is followed. To make a fair valuation the bank needs information. The authors of this thesis were interested in how the information would change as a result of an abolishment of the audit duty. FAR SRS see a big problem in the abolishment and addresses the highly important matter of the ongoing bookkeeping and believe in a change towards a more coaching role for the auditor. Företagarna does not see any problem at all with an abolishment and also believe in a more coaching role for the auditor. Since FAR SRS and Företagarna have the opposite opinion of the value of the audit duty it is an interesting finding that both parties see coaching as the future. Even though coaching does not necessarily mean that a company's financial statements can be assumed to have the same quality, it will without any doubt increase its validity. UC does not see that not having audited financial statements will make a difference in its product, but since part of the product they provide is based on annual reports the coaching idea will probably increase the reliability of UC's product too.

The changes that will face the banks as a result of an abolishment of the audit duty is that they have to find additional information to use in the valuation process. This does not mean that they cannot use the financial statements at all rather that they have to focus more on the other information sources that they have to their disposal. Judging by the result from the analysis on the respective banks Nordea will face the biggest challenge since they are more focused on figures than SHB. The authors have no doubt in that the additional information that can be deduced by analysing the information from model 3-1 will give reliable and valid information to generate a fair valuation for a company.

Svensson & Ulvenblad (1994) as well as Svensson (2003) discuss the problems that arise when there is a skewed information flow between the company and the creditor. According to the theory of skewed information, it can be more difficult for a smaller company than a large company to receive credits due to that the bank cannot obtain the needed information. If the audit duty is abolished there may be even greater problems with skewed information flows than it has been prior to the abolishment.

5.4 Corporate valuation

Valuation of a company's financial position is one of the most important aspects in assessing a company's creditworthiness. This is called financial analysis in model 3-1. As a result of an abolishment of the audit duty the financial analysis cannot be trusted in the same way as it has been previously. Exactly how it will differ is hard to say, but the fact that an auditor has not approved the accounts means that they have not been scrutinised by an expert.

In the interview with Nordea they stressed the growing importance of using cash flows as a measurement combined with ratios focusing on current figures. Analysing a cash flow by only looking at the forecasted figures gives a view of a company's predicted income streams, in a valuating process for a small company it can be seen as somewhat weak. Since small companies are not always listed on a stock exchange, i.e. it is not possible to value the company based on its market value, there is a need for comparing different companies with each other as well as with an industry average. An abolishment of the audit duty will probably force the banks to develop their valuation criterion, especially the financial analysis. Due to this the authors agree with Nordea's view that there is a need in further developing the analysis based on cash flows. Discounted cash flows can be used not only to compare a company to the market average but with other companies as well, and the authors see it as a good measurement tool in the valuation process. It is connected with some difficulties, for example choosing a proper discount rate. The overall pros and cons of DCFs have been discussed in the frame of reference chapter and will not be discussed further. (Frykman & Tolleryd, 2003)

Although SHB does not seem to be facing the same challenge as Nordea as a result of an abolishment, it must still be of interest for both banks to develop a way to value the company based on its financial situation. Even if SHB claims that they are not as focused on figures as other banks due to its decentralised organisation the financial analysis cannot be ignored. The cash flow is the income stream for a company and without any money coming in to the company they will not be able to repay a loan, hence a loan will not be approved.

Analysing a company based on only one financial aspect will probably not generate a fair valuation. All the financial statements should be thoroughly analysed, and a good way to do this is using ratios. Nordea addressed the aspect of using ratios show a difference quickly. What is meant by this is that for example the ratio estimating the solidity of a company will not show a difference as fast as for example interest-bearing debts compared to EBITDA. Even though ratios are based on financial statements, hence will be affected by an abolishment, and might be questioned in the future the comparison feature they possess cannot be overlooked and it does not seem likely that they will not be used in the future. It is seen as a good complement to other financial measurement tools. (Frykman & Tolleryd, 2003)

The authors of this thesis see above discussed topics as interesting cogs for the financial analysis in a changed valuation process. Added to this are also the other three parts presented in model 3-1. Different banks will probably face different problems as a result of an abolishment of the audit duty, but predicted by the authors is that depending on how well the four different parts of model 3-1 is used different amount of time have to be allocated to developing the different parts. The authors have no doubt in that the banks will, depending on needs and resources, develop new ways to make fair corporate valuations.

5.5 Credit rating

Svensson & Ulvenblad (1994) determined five variables that need to be fulfilled by a company for a credit application to be approved. These different variables assess the creditworthiness for a company. The changes that will affect the variables as a consequence of an abolished audit duty will be discussed below in the order they are presented in the frame of reference chapter.

The first variable is the *capacity* which is analysing a company's ability to repay the loan based on different ratios. The use of ratios has been discussed in the corporate valuation

part of this chapter, but some additional comments can be made since this part will be a discussion of the implications that the bank industry will face. The authors see a change towards relative ratios, since this is where the differences can be found at early stages. Since the figures in the accounts will not be quality approved by an auditor in the future, changes need to be found earlier.

Next variable to discuss is the *character*, which is assessing the candidate's willingness to repay. The resource analysis from model 3-1 can give a good understanding of the management's view of handling its finances. The previous discussion on the value it can add to the credit process is of interest here as well. If the employee at the bank is well understood with the aims of the company and trust the management it will probably make it easier to estimate the company's willingness to repay a loan according to the amortisation plan set up by the bank.

The *capital* available in the company is a security for the bank if the company will fail to pay according to the preset plan. This is a part that probably will not be affected by an abolishment of the audit duty, but is still of interest for the bank. Liquid assets are important if the company would face financial difficulties since the creditor can be more certain of its value than for example inventories.

The forth variable to be analysed is *collaterals*, which the authors predict to have an increasingly important role in the future. Since an abolishment of the audit duty will raise questions on to what extent the figures in the financial statements can be trusted, using collaterals can be an easy way to secure the loan. If the bank is not completely certain about the valuation made, they can demand collateral as a complement. Some companies are more difficult than others to value, and if the financial statements cannot be fully trusted since they are not audited, collaterals can solve the problem.

The last variable addressed by Svensson & Ulvenblad (1994) is the *condition*. It is connected to the business climate where the company operates as well as the business cycle for the industry. The environmental analysis from model 3-1 can be used when assessing a company's creditworthiness. The arguments used for the analysis combined with a more in depth analysis of the business climate combined with the political situation for the company needs to be done. As for the implication of an abolishment of the audit duty, the difference will probably be mostly the discussions addressed in the environmental analysis.

6 Conclusion

In this chapter the research questions will be answered in the order they are stated in chapter one. Finally some suggestions for further studies will be presented.

How is an abolishment of the audit duty viewed by organisations that are represented in the thesis?

The different organisations represented in the sample of this thesis have, as the authors expected, different perceptions of the value of the audit duty. Figure 6-1 that has been developed in the analysis presents the organisations' opinion of the audit duty, with those valuing it the most on the left. FAR SRS's and Företagarna's position are not particularly surprising. The position of the three other companies is more interesting.

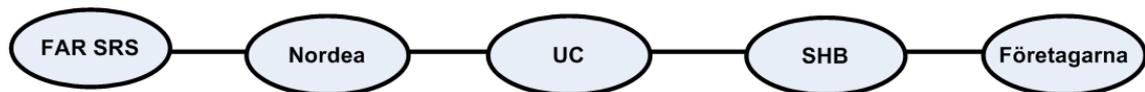


Figure 6-1 The value of the audit duty according to the interviewees

The difference that the banks are showing depending on their organisational structure addresses how important a bank's routines are in the process of valuing a company's creditworthiness. Nordea, which is the most centralised bank, values the audit duty high and believes that they will still demand audited financial statements. SHB on the other hand see a value in audited financial statements, but claims that other information sources are more important.

How would the information that needs to be given to the banks in order to make a fair valuation of the company's creditworthiness be affected by an abolishment of the audit duty?

Model 3-1 in the frame of reference states four different areas which have to be analysed in order to assess a company's creditworthiness correctly. As a consequence of an abolishment of the audit duty the authors believe in increasing importance of the information that the *business concept*, *environmental analysis* and *resource analysis* can generate. Developing those parts of the model might to some extent compensate for the value lost that the abolishment will cause. Depending on the information that a bank presently uses in the credit process the development needed will differ. By this not meaning that the *financial analysis* will not have a value. It will probably need some development complementing the changes that an abolishment will cause.

When using other sources of information besides financial statements it is important to interpret the information correctly. Using financial statements different ratios can be used to assess a company's financial situation. When using information that does not consist of figures the importance of the information increases.

As a consequence of an abolishment of the audit duty what possible differences will occur for the organisations represented in this study?

The authors predict that the relationship between the company, accountant and auditor will change towards more coaching. This will also develop the relationship between the company and the auditor further (see model 5-1). As an influence for Sweden the English case will give a good insight on how this might work.

UC does not seem to be particularly affected by an abolishment, but the banks are likely to have to change its work process and value other types of information besides the financial statements.

6.1 Suggestion for further studies

The authors predict that some sort of complement would be needed replacing the audit duty. To conduct a study in five or ten years to see whether a complement have been developed and in that case compare it with the audit duty in the assessment of the creditworthiness for a small company. This would include discussions on how the information is collected and how it is used.

At present time no threshold levels have been set yet. To conduct a study in ten years time discussing the threshold levels and if any similarities with the English case would also be of interest.

This thesis has been using a qualitative research method. Performing a quantitative analysis using for example the four different types of errors that probably will occur would be interesting. This might give a view of the importance of audited statements for the financial analysis.

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8 Appendices

8.1 Intervjuguide - FAR SRS

Revisionsplikten

- Vad är den allmänna uppfattning om värdet på revisionsplikten enligt FAR SRS?
- Hur tror ni att revisorns roll för små företag kommer att förändras vid en slopning av revisionsplikten?
- Hur tror ni att FAR SRSs medlemmars klientel kommer att påverkas av en slopning av revisionsplikten?
- Då kreditgivare har möjlighet att kräva reviderade årsredovisningar, även om ingen plikt finns, vad tror ni att detta kommer att leda till?

Information

- Hur tror ni att trovärdigheten på små företagens årsredovisningar kommer att förändras?
- Hur tror ni att kvalitén på årsredovisningarna kommer att påverkas?
- Tror ni att en alternativ kontroll kommer att behövas för att kunna säkra tillförlitligheten på årsredovisningar?

8.2 Intervjuguide - Företagarna

Revisionsplikten

- Vad är den allmänna uppfattning om värdet på revisionsplikten, för medlemmarna i Företagarna?
- Vid en eventuell slopning av revisionsplikten, tror ni att era medlemmar kommer att fortsätta att ha reviderade årsredovisningar?
- Hur anser ni att förhållandet mellan kostnad och nytta med reviderade årsredovisningar ser ut?
- Vilka problem och/möjligheter tror ni kommer att uppstå för era berörda medlemmar vid en slopning av revisionsplikt?

Information

- Hur skall företagen kunna lyfta fram värdet i företaget utan bevis som reviderade årsredovisningar?

Företagsvärdering

- Hur ska företagen kunna bevisa att informationen som ligger till grund för värderingen av ett företag är korrekt utan reviderade årsredovisningar?

8.3 Intervjuguide – Handelsbanken

Revisionsplikten

- Vad är den allmänna uppfattning om värdet på revisionsplikten, för Er?
- Vid en eventuell slopning av revisionsplikten, tror ni att ert klientel kommer att ändras?

Information

- Vilka förändringar, om några, skulle krävas på insamlingen av den information som ligger till grund för kreditbedömningen?
- Hur bedömer ni trovärdigheten på insamlad information som ni använder er av vid kreditbedömning?
Hur tror du att detta kommer att förändras om revisionsplikten slopas?
- Förutom årsredovisningar, vilken annan information ligger till grund för ert kreditbeslut?

Företagsvärdering

- Vilka företagsvärderingsprinciper används idag?
Skulle dessa kunna användas om revisionsplikten slopas?
Måste alternativa modeller utarbetas om revisionsplikten försvinner?
I så fall, vilka egenskaper för en alternativ modell skulle behövas?

Kreditbedömning

- Vilka svårigheter och problem skulle kunna uppstå vid kreditbedömningsprocessen av ett litet företag, om revisionsplikten försvinner?
Anser ni att det finns positiva effekter av en slopning av revisionsplikten?
I så fall vilka?
- Kan man andra avtal mellan kreditgivare och kredittagare ersätta revisionsplikten?
I så fall, på vilket sätt?

8.4 Intervjuguide – Nordea

Revisionsplikten

- Vad är den allmänna uppfattning om värdet på revisionsplikten, för er kreditanalytiker?
- Vid en eventuell slopning av revisionsplikten, tror ni att ert klientel kommer att ändras?

Information

- Vilka förändringar, om några, skulle krävas på insamlingen av den information som ligger till grund för kreditbedömningen?
- Hur bedömer ni trovärdigheten på insamlad information som ni använder er av vid kreditbedömning?
Hur tror du att detta kommer att förändras om revisionsplikten slopas?
- Förutom årsredovisningar, vilken annan information ligger till grund för ert kreditbeslut?

Företagsvärdering

- Vilka företagsvärderingsprinciper används idag?
Skulle dessa kunna användas om revisionsplikten slopas?
Måste alternativa modeller utarbetas om revisionsplikten försvinner?
I så fall, vilka egenskaper för en alternativ modell skulle behövas?

Kreditbedömning

- Vilka svårigheter och problem skulle kunna uppstå vid kreditbedömningsprocessen av ett litet företag, om revisionsplikten försvinner?
Anser ni att det finns positiva effekter av en slopning av revisionsplikten?
I så fall vilka?
- Kan man andra avtal mellan kreditgivare och kredittagare ersätta revisionsplikten?
I så fall, på vilket sätt?

8.5 Intervjuguide - UC

Revisionsplikten

- Vad är den allmänna uppfattning om värdet på revisionsplikten, för er på UC?
- Vid en eventuell slopning av revisionsplikten, tror ni att ert klientel kommer att ändras?

Information

- Hur tror ni att er produkt/service kommer att påverkas vid en slopning av revisionsplikten?
Hur stor del av värdet på er produkt anser ni ligga i att årsredovisningarna är reviderade?
- Vilka förändringar, om några, skulle krävas på insamlingen av den information som ligger till grund för er bedömning?
- Hur bedömer ni trovärdigheten på insamlad information som ni använder er av vid bedömning?
Hur tror du att detta kommer att förändras om revisionsplikten slopas?
- Förutom årsredovisningar, vilken annan information ligger till grund för er värdering?

Företagsvärdering

- Vilka företagsvärderingsprinciper används idag?
Skulle dessa kunna användas om revisionsplikten slopas?
Måste alternativa modeller utarbetas om revisionsplikten försvinner?
I så fall, vilka egenskaper för en alternativ modell skulle behövas?