Demand For Auditing In Small Firms
An Impact On Small Companies In Sweden That Are Not Required By The Legislation To Have Their Accounts Audited.
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DEDICATION

This work is dedicated to my beloved family:
Mr. Dickson Table Arrey and Mrs. Lydia Ndip Arrey (parents).
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Abstract

Despite the vital role that statutory auditing plays in enhancing trust or credibility over the financial statements of business entities, most member states in the European Union community have decided to grant a waiver or exempt small companies from the service in order to reduce administrative burden and cost for these companies. In Sweden this is still a proposal that will be in effect by 2010. Since accounting has become the way firms measure their performance, auditing has also become an increasing need for users of accounting information such as stakeholders. This paper presents an investigation on the banks opinion and reactions about the new proposal or legislation concerning small companies in Sweden that will be exempted from statutory auditing. The study is focused on the banks perspective since banks are key players in providing funds to small companies and enabling their survival. In granting loans to companies, banks always require them to provide audited financial statements for assurance and credibility purpose. Thus our empirical findings have been carried out through the inductive research method based on three interviews undertaken with some personnel of the management of three major banking institutions in the city of Umea and Skelleftea. From this study we found that though statutory audit will be removed for small companies by government, banks will still require these companies to provide them with audited financial statements when it comes to granting loans to companies. Unfortunately, this policy may backfire as it opens the floodgates for companies to manipulate by keeping low figures to avoid tax or high to increase credibility.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Acknowledgement</th>
<th>ii</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dedication</td>
<td>iii</td>
</tr>
<tr>
<td>Abstract</td>
<td>iv</td>
</tr>
<tr>
<td>Table of Contents</td>
<td>v</td>
</tr>
</tbody>
</table>

## CHAPTER ONE: INTRODUCTION

1.1 Background to the Study                      - 1
1.2 Research Questions                           - 3
1.3 Purpose of the Study                        - 3
1.4 Limitations                                 - 4
1.5 Definition of Key Words                     - 4
1.6 Disposition                                - 5

## CHAPTER TWO: METHODOLOGY

2.1 Choice of Subject                            - 6
2.2 Preconception                                - 7
2.3 Perspective                                 - 7
2.4 Research Approach                           - 8
2.5 Research philosophy                         - 8
2.6 Research Design                             - 9
2.7 Research Methods                            - 10
2.8 Data Collection                             - 10
2.9 Credibility                                 - 12
2.9.1 Reliability                               - 12
2.9.2 Validity                                 - 12

## CHAPTER THREE: Literature review

3.1 Development of Auditing                     - 15
3.2 What is Auditing                            - 17
CHAPTER ONE

INTRODUCTION

In this chapter we are going to present the background of the study, the research questions and purpose of the study. We will go further to give our limitations of study, definition of keywords and finally we shall give a disposition of the thesis.

1.1 Background to the Study

From the existing literature, one can see that auditing has had a long past and with a lot of tremendous changes. According to Hayes & Rick (2005), anthropologists found records of auditing activities as far back as the early 3000 BC. Auditing existed in countries such as ancient China, Rome and Greece. This chapter provides the reader with an introduction to the study. It starts by presenting the background to the study, that is, the history and importance of auditing. This is followed by the introduction of the research questions, purpose of the study, limitations, definition of key words and finally with the disposition of the study.

According to McNamee and McNamee (1995), the earliest records ever audited were Babylonian Clay tablets some 5,000 years ago. Auditing has undergone remarkable changes in the past few years. There are different types of auditing (e.g. internal, external, tax assessment, etc). It has existed since ancient times when stewards gave accounts to their masters on assets/properties entrusted to them. Since then, there have been a lot of changes in Auditing. Change is not an event; it is a process of living and growing in the environment. The same is applicable to business organizations as the systems have continued to change and grow in size throughout the industrial age. As the business systems expand so also is the auditing professions. Auditing is moving from a phrase where adaptation and transformation takes place

Auditing and Accounting are related though they have different natures but they are some how complementary because they have same subject matter but their function tools and approaches vary. Accounting is the collection, classification, summarization and above
all communication of financial data, which involves a critical examination, judgment and comment on the accounts and administration of an entity. While auditing involves, critically examine, judge, comments on the accounts and administration of an entity (Mautz and Sharaf (1961). From this definition, Auditing acts as a detective for owners of companies and as an information satisfier to stakeholders (Cosserat, 2000). Since accounting information represent the way in which firms measure their performance, auditing has become an increasing need for users of these information such as creditors, investors, bondholders and other interested parties in the business world to get assurance if these information reflects the actual situation of companies. Without accurate firm specific information, investors may align their portfolio in a less than optimal fashion resulting in an efficient allocation of resources in the society (Wallin, 1992).

Following major financial scandal caused by accounting fraud in some top organizations such as Enron, Parmalat and World com just to name a few, investors began to lose confidence in company’s financial reports. To rebuild this confidence, some government around the globe required all business organizations to have their accounts audited by a qualified independent auditor before reporting their financial statement to the public. “An audit is better than no Audit” (Hay & Davis, 2004).

The increasing demand of auditing has led owners of business organizations to monitor their agents (managers) in order to protect their interests and to avoid any conflict of interest that may arise between the two parties. Auditing can be purchased to provide credibility to managerial disclosure necessary to distinguish among firms of different qualities (Wallin, 1992).

Small and Medium Enterprises (SME) play a major role in the economic development of each nation around the globe. They are considered as an engine of economic growth. To expand and achieve their growth, these small organizations always seek additional external financial resources to carry out their daily operations and to ensure their continuity in the future. Since ensuring that the business continues as a going concern is also important to lenders (Collins & Jarvis, 2002).
As small firms find it difficult to sell shares to the public, the best source for them to get access to these financial resources is for them to meet creditors such as banks to enable them get adequate finance and it’s highly recognized that banks are the main source of finance for SME (Collins & Jarvis, 2002). Banks will rely on the financial information presented by this entity before providing them with adequate finance that is requested. The reliance on this information by the banks will depend on their credibility. And what then can assure this credibility or fairness of this information is for the banks to know whether these financial statements have been audited by an independent qualified persons. So following the proposal made by the Swedish legislation that small firms are not required to have their accounts audited leads us to the following research questions.

1.2 Research Questions
Our research questions will be based on finding out answers to the following questions. Q1. What is the banks opinion about the New Legislation removing statutory auditing for small companies?  
Q2. What will be the reaction of the banks if small companies’ accounts are not audited and how are they going to restore trust/assurance over the Financial Statements of small companies?

1.3 Purpose of the Study
The purpose of this study is to carry out an investigation on the impact that this legislation may have on the financial statements of small companies in Sweden and to find out the reactions of the creditors such as banks towards the SME financial Statements.

1.4 Limitations/Focus
Due to time constraint our research work will be limited only to SME in Sweden and particularly in Umea/Skelleftea. We shall rate a firm as a small firm using these criteria. That is we shall measure small firms in terms of the companies turnover (i.e. from below
85 million SEK), number of employees (that is below 50 employees) and balance sheet assets (below 30 million SEK). If a company meets two out of the three criteria then we shall term it a small firm. That is to say the company does not necessarily follow all the criteria to be called a small firm. Also, taking cognizance of the fact that there are many users of the company’s financial information such as the banks, investors, employees, tax authorities, etc. who uses the companies financial information to make their economic decisions, we would have loved to have the opinion from either the investors or the tax authorities related to this proposal but because this will be too much work for us taking the time frame we shall focus only at the level of the Banks. That not withstanding another limitation will come from language barrier. Taking into consideration that our working language will be English and most people in Sweden speak but Swedish this also will be another hindrance to the study.

1.5 Definition of Key Words

**Auditing**: Auditing is defined as a systematic process of objectively obtaining, evaluating evidence regarding assertion about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users (William et al, 2006).

**Small companies**: The definition of small companies following the EU legislation is the economic size which is the company’s turnover (£5.6million), balance total assets (£2.8million), and number of employees (50 employees). If a company’s meet two out of the three criteria it’s then qualified as a small company.

**Statutory Auditing**: This is when a company is obliged to be audited by an external independent auditor (a certified accountant) and this is required by the law. Just like what is applicable now in Sweden.

**Financial Statements**: It’s composed of the company’s accounts such as cash flows, income and expenses account and balance sheets for an accounting period.
1.6 Disposition.
Here the authors are simply going to give a layout about what will be covered in the rest of the chapters, starting from chapter two to the end.

Chapter two: In this chapter we shall present and discuss our research methodology. We shall discuss the research methods to be used and the justification for using those methods against others. Also, we shall discuss how empirical data would be collected to provide answers to the research questions and our choice of study.

Chapter three: This chapter will be based on Literature Review also known as Theoretical Frame-work. In this chapter we are going to present to our readers exiting or previous theories related to our area of study.

Chapter Four: We are going to deal with the empirical findings, extracted from the data collected from respondents, which would underpin our analysis, discussions and conclusions.

Chapter Five: Chapter Five is the analytical part of the work were we shall present an analysis of the data collected from the interview and previous literature to come out with some conclusion, discussion and recommendations.

Chapter Six: In the last chapter we are going to present our conclusions based on the findings from the empirical data and theories and also give recommendations and suggests areas of future research.
CHAPTER TWO

METHODOLOGY

In this section of the work we are going to explain what kind of research methods we choose to use and why it was chosen for our study. We shall base our attention on the choice of study, preconception, perceptive, research approach, research methods, research design and finally data collection methods for our thesis.

2.1 Choice of Subject

The failure of Banks around the globe and other giant profitable organizations like BCCI, Worldcom, Xerox, Maxwell, Parmelat and Enron, which led many individuals or investors to lose their wealth raised fundamental questions as to a proper auditing function, armed with an appropriate control mechanism which existed in these organizations. Following these failure or scandal of banks there has been an increasing need for these organizations to rebuild trust and assurance to their customers or investors. To face this situation, many banks or other companies around the globe have tried to improve auditing services through, which outsiders (i.e. customers, investors, suppliers creditors, government etc.) can be informed about their management system and control mechanism, so as to enhance their degree of confidence and assurance of what is going on in these organizations (Joseph, 2005).

Our main interest in this subject has been motivated from knowledge achieved from previous studies in the department of Accounting and Finance and in particular the Advanced Auditing and Assurance Service course. Both authors (Arrey and Gabsia) found their topic “Demand For Auditing In Small Firms. An impact on small firms in Sweden that are not required by the legislation to have their accounts audited”. The topic is more relevant because of the important role that auditing plays in the prevention and detection of fraud or risk. Not only because of the above mentioned reason, but also the topic is relevant to both authors as the knowledge gained will help us improve our economic situation back home in terms of putting in place proper auditing mechanisms.
This notwithstanding the authors strongly believed that the results obtained from the study will be useful for our professional career.

2.2 Preconception

Basically, it’s obvious that when writing a thesis one should remain as objectively as possible. One must possess some basic experience, knowledge and a high degree of interest in a well defined field of study before undertaking a research on a topic related to a particular field. Also, the styles in which individuals interpret the same phenomenon differ due to their social and cultural background.

Both authors are of the same nationality and have the same educational background. We both read Accounting in the undergraduate level and have working experience in different discipline for so many years ranging from 5 to 12 years.

Currently, we are business students with specialization in Accounting and Finance and have both acquired some thorough knowledge in Auditing at both undergraduate and master levels of study. Therefore, our preconception generates from our previous studies in Advanced Auditing and Assurance Services which enable us to formulate our topic.

2.3 Perspective

According to Eriksson and Wiedersheim-Paul (1997) perspective can best be explained as the point of view chosen to enable one focus on a problem from different dimension. The manner in which individuals looks upon reality or how reality is being perceived will depend on the individual judgment as this will have an influence on the choice of perspective. For a good research work to be conducted in a particular perspective to permit a better understanding of the subject matter, this will vary depending on the discipline of the individual. Since, they will have different ways of looking and analyzing problems.

Our topic “Demand For Auditing In Small Firms. An impact on small firms in Sweden that are not required by the legislation to have their accounts audited” will be viewed by
us from an auditing perspective since the study will be based on some theories relating to auditing.

2.4 Research Approach

Research approach is more concerned with the way in which the researcher will collect data to answer his/her research questions (Saunder et al., 2000). The research philosophy depends on the researchers’ interpretation of the development of knowledge. It is rather profound and not something which you will give much thought as is just simply the way we go about doing research to develop knowledge (Saunder et al., 2000). Therefore, it will be necessary to use an appropriate method to achieve the best foundation of the study. Since research is linked to theory and there is a relationship between theory and research which help to guide the researcher on which theory to use and from the theory you used it will determine your research design and which methods you will use to collect your data.

Basically, there are three different research approaches (Bryman. & Bell. (2007). We have the inductive, deductive and abductive approaches. The deductive uses the hypothesis testing to derive its outcome. The inductive approach is about findings associated with certain enquiry that is what is reality? while the abduction is a combination of both the deductive and inductive. Depending on which theoretical method one chooses has a link to the research design and methods to use. In our research we shall use the inductive theory because we think it is the best approach that has a link on research methods to answer our research questions. Not only that but since we have to find answer to our research questions, we believe the inductive view is vital because it will affect the manner in which the research will be conducted to know the truth that one is searching for. This research approach also has a link with the research philosophy.

2.5 Research philosophy

The ability to choose the best appropriate research design for answering the research questions depends on the research philosophy. There are two research philosophies. We have the epistemological and the ontological philosophy. The epistemological stance
deals with how it is possible to know about the world. It is divided into two parts: positivism and interpretivist. The positivism is an epistemological position that asserts the application of the methods of natural sciences to the study of social reality and beyond. While the interpretivist position requires that social scientist should hold subjective meaning of social action.

On the other hand, the ontological deals with nature of the world and what we can know about it. According to Hammersley 1992, cited by Ritchie and Lewis (2005), ontological position is a “subtle realism”. Meaning we accept that social world does exist independently by individual subjective judgment. The ontological stance is also divided into Objectivism and constructionism. Objectivism is an ontological position that asserts that social phenomena and their meanings have an existence that is independent of social actors (Bryman & Bell, 2007). While constructionism is an ontological position which also asserts (accepts) that social phenomena meanings can be continually accomplished by social actors and that reality of social world is constructed and does exist out there (Bryman & Bell 2007). Following these concepts in relation to our study for the epistemological stance we take the interpretivist position while for the ontological stance we take the constructionist view point. Reason being that in our research, we will be able to investigate the extent to which banks are going to re-act following the new proposal by the Swedish legislation. As the various respondents are going to express their individual viewpoints based on their subjective judgment this will be in support of the interpretive and constructional view points.

2.6 Research Design

According to Bryman & Bell, 2003, there are five different research designs which are the experimental, cross-sectional, longitudinal, case study and comparative designs. Longitudinal is a research capacity which studies change and development in business research. A cross-sectional method is the analysis of data gathered from more than one case at a single point in time in order to collect a quantitative or quantifiable data in connection with two or more variables, which are then examined to detect patterns of association. The case study design is development of detailed and intensive knowledge
about a single case or multi-cases. It deals with the complexity and particular nature of the case in question. It can be in terms of events, locations, persons, organization etc. Therefore, to select a research design it will be good for the researcher to select the best methods which will enable s/he carry out the study. After examining the different methods we choose to use the case study design in our research work. We decided to select the case study because we would focus on 3 banks with similar characteristics.

2.7 Research Methods
There are two main research methods. We have the qualitative and the quantitative methods. The quantitative methods employ measurement that can be quantifiable while qualitative cannot be measured. It could also be differentiated by the connection between theory and research which help in determining which methods to use (Bryman & Bell, 2007). Therefore, to enable us have a clear and deeper understanding in relation to our research question and purpose, we strongly believe that it’s appropriate to carryout our research work using the qualitative method because it will be a suitable method to provide us with an appropriate technique for the study that also has a relationship with our research approach chosen above and a link on how data would be collected and analyzed.

2.8 Data Collection
Data collections are the means by which you gather relevant information to enable you provide answers to your research questions. Basically there are two main sources for collecting data. We have the primary and secondary sources. The Primary source of data collection is when the researcher collects first hand information using survey methods such as observations, interviews, questionnaires which is followed by an analysis of the data (Saunder et al., 2000). While the secondary data are already collected information for other purpose and perhaps processed and stored. The types of information are official documentary data, survey-based data and multiple-source data (Hakim, 1982, cited by Saunders et al. 2000).
Our data collection to answer our research questions were obtained from two different sources being the primary as well as secondary sources. We started by reading literature and articles that are relevant to our research questions to have a sound knowledge and understanding to enable us take a step forward and conduct our interview for the empirical part. At this point therefore, we found some authors and researchers whose works were meaningful and trustworthy to our areas of study.

Our secondary data that we used were obtained from the Umea University Library electronic database system such as Emerald, Business Source Premier. We also used textbooks and went further to search for information from the internet. Our data for analysis for the primary data was collected through face-to-face interview, which help us to reach at our conclusions. We decided to carry out a face-to-face interview within the banking sector in Umea and Skelleftea. We created an interview manual which could be seen in Appendix 1 that we send to our respondents by emails a week ahead of time to enable them prepare answers to the questions before the interview day in order to make sure they have the opportunity of expressing their subjective views in the same area of study. This also acted as a guideline to enable them know and prepare their mind for the interview. We structured the interview manual into three sections. Section A (Backgrounds of respondents and study area), Section B (questions before the new proposal) and Section C (questions after the new proposal was made).

All of the interviews took place at the office of the respondents which we think makes them more comfortable and relaxed to answer our research questions. With the permission from our respondents we used a tape recorder to tape all what the respondents were saying to enable us concentrate totally on the interviews so that we should not be worried about taking notes and about misinterpreting any information as we could go back and listen to the tape at any time when doing the transcription.

The interviews lasted for at least an hour. We asked every respondent if he wanted that we should include his name when writing the empirical part. Among the 3 respondents only one of them do accepted that we could mentioned his name if we wish but the other
two refused. At the end of the interview we thank all the respondents for sparing us their time.

After conducting the interview we transcribe them down word for word by listening the tape recorder. After our transcription of what we taped we forwarded the materials to each respondent by email to give them the possibility to correct and approve the material. In return, the respondents made some view points and comments which we in effect made the necessary corrections before writing our analyses and conclusion.

2.9 Credibility

Credibility is the criteria in judging the quality of any research study. Taking into account the amount of evidence used. In the case of qualitative study to determine the value of the evidence is to determine the quality or sustainability of the investigation (Ritchie and Lewis, 2005). To meet this criteria certain test of measurement in terms of reliability and validity must be fulfill to achieve the goal of the studies which we shall discuss below.

2.9.1 Reliability

Different authors talk about reliability using different words such as conformability, trustworthiness, consistency and dependability (Glaser and Strauss, 1967; Hammersley, 1992; Robson, 2002 and Lincoln and Guba, 1985 cited by Ritchie and Lewis, 2005). The main aim of reliability is to ensure that quality exists and how can it be measured? This requires a clear and better understanding of what characteristics qualitative data might be expected to have if the same study is replicated in a different setting. This is in terms of consistency, replicability and dependability. Reliability could also be referred to as the consistency to measure a concept (Bryman and Bell, 2003).

2.9.2 Validity

Validity is the measure of the correctness or precision about research findings which can best be explained using two distinct concepts. The first concept is the internal validity and the second is the external validity. Internal validity deals with whether you are
“investigating” what you are suppose to investigate in other to answer your research question(s) and if it meets your objective. While external validity involves the extent to which the “abstract constructed or tested” can be applicable to other groups within the population (Arksey and Knight, 1999; LeComptge and Geots, 1982 cited by Ritchie and Lewis, 2005).

The validity of measurement is more concerned with quantitative research but it is also recognized to be of importance to qualitative research. There are different forms of validity as described by different authors. According to Bryman and Bell, 2005, we have measurement validity, ecological validity, internal validity and external validity. But as mentioned the most common is the internal and external validity. In the context of qualitative research, external and internal validity are the most common form of validity which are used to verify accuracy or truth in what is investigated. The accuracy reflecting this phenomenon therefore will be the strength of the research method used and also the quality on how the data is analyzed and interpreted.

Therefore, in relation to our research study in order to measure validity and reliability, we decided to use a qualitative research method which we think is the best method to use in order to have a deeper understanding of our research questions. Also our research design selected is the appropriate form which we think is associated with qualitative study. In collecting our primary data we decided to conduct an interview, which we first of all formulated an interview manual that we think is in accordance with our purpose and problem of study. We did send the interview manual to our respondents before the interview dates to enable them have a sound knowledge and get themselves well prepared for the interview. Also to avoid bias and inaccuracy of information we decided to interview three respondents from three different banks in Umea and Skelleftea.

Since the Swedish banking companies are made up of four large banks – Swedbank, Handelsbanken, Nordea Bank and finally SEB. We decided to focus on any three out of the four banks that is going to accept our request for interview and we think analyzing three from the four banks will give us enough information to answer our research
questions and make conclusion. We therefore think and hope that the information that we obtained from the interview are reliable and appropriate for this study taking into consideration the number interviews and the information gathered.
CHAPTER THREE

LITERATURE REVIEW

Literature review is based on reviewing previous/existing theories related to what had been written about your research areas. It helps you to identify/gain an understanding about existing ideas about your subject, concepts and theories which are relevant and above all if there are any consistencies or implications on the research area. Our literature review is divided into three sections. The first part dwells on Auditing, the second part looks at Small and Medium Enterprises while the third part focuses on Banking.

SECTION A: AUDITING

3.1 Development of Auditing

The development of auditing is just how auditing has evolved from the ancient time to the present date and the changes which took place during those periods. Auditing started as far back as 5000 years ago where Babylonian clay records were audited. By then the middle Kingdom of Nile and Pharaoh’s deputy over saw the storage of grains. Auditing during this period was a matter of re-performing the work of others, which was observing, counting and double-checking of records (McNamee and McNamee, 1995).

Also auditing existed during the Roman Empire era. It was used by Italian merchants to assist in the verification of the accountability of the sailing-ship captains who was returning from the old world riches bound for European continent (Brown, 1962). According to Dale et al (2003), auditing of business has been traced back about 15 years to development in Great Britain in the middle of the nineteenth century. After the industrial revolution in the nineteenth century, there was an increasing need of capital for investment. During this period limited companies increased in number and in sizes. As these companies increased in size, they became involved in so many complex operations in their daily activities and this resulted in a need to separate ownership and control in these companies in which experienced individuals were employed by owners to run and
manage their businesses on their behalf. To get assurance of what these individuals were
doing, auditing was then demanded by many stakeholders as a means to help monitor
their agents. The British Company Act of 1862 as amending the Joint Stock Companies
Act of 1844 to encourage the employment of auditors to represent shareholders and to
examine the company books and statement of account to ascertain that funds of the
company have been properly accounted for (Flesher, 2003). During the early days,
auditing techniques consisted almost exclusively of detailed verification of every
transaction which had taken place (Brown, 1962). From this early stage to this present
era, there have been many changes in auditing. Auditing now consist primarily of a
procedural review with the analysis of effectiveness of internal controls providing the
major basis for the procedural appraisal (Brown, 1962).

Following major accounting fraud and irregularities of some big corporations around the
globe, many governments have required companies to have their accounts audited before
publishing them and as a result, many pieces of legislation about statutory auditing in
companies became a major concern to many governments. In Sweden the first statutory
audit for stock companies was enacted through the Companies Act of 1895 and during
this period the auditor was considered as lay-person from 1910 to 1975 (Larsson, 2005).
The Companies Act of 1910 required employees and members of the board of directors to
not be appointed as auditors and this led to the demand of state employed auditors. In
1944 there was a pre-requisite to auditing managing directors as well as the financial
accounts and this defined the way auditing can be performed. In 1975 the auditor’s
duties were changed from detailed description to being defined with the help of the
concept of generally accepted auditing standard. This has enabled a dynamic
development of the profession’s methods (Larsson, 2005).

As business organizations and systems continued to change both in size and complexity
so also was the development of auditing. Auditing therefore, is shifting from the
traditional system of checker checking to a modern system where sophisticated risk
modeling, computer assisted techniques, statistical sampling as well as customer-focused
is part of the audit process. Which means auditing is shifting from substantive auditing to
system base auditing models (McNamee and McNamee, 1995). In other words we can say auditing is shifting away from the traditional accounting and audit services to a wider perspective of an assurance services. Furthermore to conclude this part we can say since all the authors are not given a particular date as of when auditing started, this implies auditing existed several thousand years ago from when the owner first assessed result of his steward whom he entrusted his business and property under his management or control.

### 3.2. What is Auditing

The word “auditing” comes from the Latin word audire which means to “hear” (Cosserat, 1999). So far as auditing is concerned, there is no particular definition since different authors have different definition about auditing. As defined by International Standard on Auditing (ISA) 200 cited by Hayes et al. (2005), which states the objective of an audit of a financial statement is for the auditor to express an opinion if the Financial Statements (FS) are prepared in accordance with Financial Reporting framework. The phrases used by the auditor to express his opinion are “true and fair view” or “present fairly” in all material aspects. The problem with this definition is that it’s been restricted only to the examination of financial statements which other auditors believe that “present fairly” and “true and fair view” though some how not equivalent terms.

Auditing is defined as a systematic process of objectively obtaining and evaluating evidence regarding assertion about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users (William et al, 2006). Turley and Cooper, 1991 also said an audit is when an auditor independently examine and expresses an opinion on the financial statements of an entity.

While Föreningen auktoriserade Revisorer (FAR) 2001, define auditing as a situation of critically examining, judging and above all commenting on the accounts and administration (Far, 2001).
According to Cosserat (1999), an audit could be described as providing a high but complete assurance about the assertion made by another person in regards to positive assurance that the financial statement are free from material misstatement. Also Eilifsen et al. (2006) the widely cited general definition of auditing is as follows:

“Auditing is a systematic process of objectively obtaining and also evaluating evidence concerning the assertions regarding the economic actions and events to ascertain the degree of correspondence between those assertions with established criteria to communicate the results to interested users”.

Therefore, from the different definitions it’s but obvious that there is really no particular definition per se to auditing but the general sense is that auditing acts as a detective for owners of business and as an information satisfier for stockholders.

3.3 Types of Audits
Audit can be carried in a company in many ways and according to Hayes et al. (2005) audit are classified into three types. We have financial statements audit, operational audit and compliance audit.

3.3.1 Financial Statement Audit
Financial statements are considered to be the focal point of interest to many stakeholders such as investors, banks and other creditors just to name a few. Hayes et al. (2005) defined financial statement auditing as the examination of an entity's financial statements to determine if they give a true and fair view or fairly present the financial statements in conformity with specified criteria. Following the Enron scandal which caused many investors to lose faith over the financial reporting of many corporations, the audit of financial statements by independent person was the only means to rebuild confidence or trust on the reliability and assurance of the financial information presented by managers in major corporations. “Reliable information is necessary if managers, creditors and regulatory bodies are to make informed economy decisions (Eilifsen et al., 2006). During the past decade the audit of financial statements has led many companies around the globe to go public by acquiring more funds to increase their capital through the sales of their stock. By adding the audit function in a business organization, the users of financial
statements have reasonable assurance that the financial statements do not contain material misstatement or omission (Eilifsen et al., 2006). Furthermore, according to Cosserat (1999) the ISA 200 states that “the objective of a Financial Statement audit is to enable an auditor to express his opinion about the Financial Statements in general, thereby providing a reasonable assurance whether the Financial Statement gives a true and fair view and is prepared in accordance with the general acceptable accounting principles or requirements. This type of auditing is only performed by an external auditor and constitutes the focal point of our topic.

3.3.2 Operational Audit
An understanding of how an entity operates is a major concern of all parties that have interest in it. “Operational auditing is a study of a specific unit of an organization for the purpose of measuring its performance” (Hayes et al., 2005). This service is provided by a company’s internal auditor, which consists of reviewing an organization performance so as to evaluate the effectiveness and efficiency of its operations. Since owners of business entities are much more interested to know whether the resources invested in their business are adequately utilized by their agents to achieve their objectives, operational audit therefore is primarily conducted to identify the cause of problems or to enhance the efficiency or effectiveness of operations (Eilifsen et al., 2006)

3.3.3 Compliance Audit
In order to prevent fraud and irregularities, all Financial and audit practice carried out in an organization must comply with certain rules and regulations. “Compliance audit involves obtaining and evaluating evidence to determine whether certain financial and operational activities of an entity conform to specified conditions, rules and regulations” (William, 2006; Cosserat, 1999). As mentioned by Cosserat, the established criteria relating to this type of auditing comes from different sources. Example management may lay down rules pertaining to over time work, conflict of interest and participation in pension scheme. Following the Enron scandal that crippled many investors the Sarbanes-Oxley Act was enacted to reform the accounting and auditing profession and protect investors in public corporations. This act requires companies to have a dual purpose
audit that audits both the financial statements and management assertion as to whether it has complied with criteria regarding an adequate system of internal control over financial reporting (William et al., 2006).

3.4 Why Auditing (Purpose/Importance of Auditing)
Auditing plays a very important part in business and even to the economy in most countries. This can be supported by the facts that all public as well as small private companies in most part of the world are required to have an annual audit of their financial statements. Not only public and private companies but also government departments, local authorities, registered charity organizations and not leaving out the non-profit organizations. Due to the importance of audit, the auditing service has faced a drastic or rapid development over the last decades (Cosserat, 1999). It permits the auditor to give an opinion of the true and fair view of the state of affairs in a company. By examining the financial information provided by management, the auditor will be able to give his judgment on their fairness as to enhance their assurance and credibility and to inform users that the company’s annual accounts are properly prepared in accordance with general accepted accounting principles (GAAP).

By the audit process, the auditor enhances the usefulness and the value of the financial statement released by management (Hayes et al., 2005). The understandability of an entity has led users of its financial information to require auditors to provide them with more information about the entity other than financial information. Their expectation goes further and includes questions such as:

- Is the company a going concern
- Is it free from fraud
- Is it managed properly
- Do directors have proper and adequate information to make decisions
- Are there adequately controls? (Hayes et al., 2005).

Auditing is useful to many stakeholders such as stockholders, banks and bondholders, suppliers, employees, the government and tax authorities to make economy decisions. These parties need auditing for several reasons:
investors rely on auditing to provide assurance about the credibility of critical information that they use when making investment decisions. Bankers and bondholder rely on audit to ensure that they are using reliable information when extending credit to companies. Other interested parties such as employees, rely on auditing to ensure that the entity will continue as a going concern in the future so as to secure their jobs and the government and tax authorities are much more concerned with accounting information for tax purposes. The various parties who are interested in company’s financial statements in making their economic decisions can be summarized in figure 1 below.

Fig. 1: Users of Financial Statements

Source: FAR 2002, p. 17

McNamee and McNamee (1995) explain that there is uniformly true, no matter the way we look at auditing either as re-performing, system auditing or whatever name we may
The simple fact is that the main purpose of an audit therefore is to compare “what is to” with “what is should be”. He went further to defined “what should be” as how the normative rules and policies are express through measurement system.

The Accounting Standard Board (ASB) states that the two main qualities of accounting information which are useful for making decisions by the financial statement users are “relevance” and “reliability”. In this regard, users of financial statements look to the external auditor’s report for assurance to be sure that both qualities (relevant and reliability) are met. The need for external audit is attributed under the following four conditions (i) conflict of interest (ii) consequences (iii) complexity and (iv) remoteness. Where there is an absence of monitoring mechanism, these four conditions will contribute to information risk and also the risk that the financial information might be incorrect, incomplete or biased. Which therefore means that an audit enhance credibility and reduces information risk on financial statements (Cosserat, 1999).

For the small companies to take loan and also make their creditors to renew their credit facilities, small companies have an incentive for their accounts to be audited by the external auditor (Tauringana & Clarke, 2000).

### 3.5 Law Regulating Auditing in Sweden

Following the Kreuger Crash in 1932 there have been many laws and regulations governing the auditing profession in Sweden. These laws were put in place as a means to guide auditors when carrying out their duties. “There is a need in society for an independent auditing profession which enjoys the confidence of those who require a high standard of auditing service as well as a sound advice and reporting on accounting matters” (FAR, 1983). The laws were issued by the Institute for the Accounting Profession in Sweden (FAR) and include: the Swedish auditors Act, the Swedish Ordinance and the Swedish Company Act of 1975. Brief descriptions of the laws are given below.
3.6 Swedish Auditor Act (2001)
The general provisions of this act is made up of 40 sections and regulates major issues concerning auditing such as the supervisory board of public accountants, approval and authorization of auditors, audit firms, professional duties of an auditor and disciplinary measures. The act gives some clarifications by explaining the meaning of an auditor and also differentiates between an approved public accountant and an authorized public accountant. The act also goes beyond by explaining how an auditor should carry an audit in a partnership or limited company. Other issue involved includes the auditor independence. “An auditor shall carry out his audit business assignment with independence and be objective in his or her opinion (www.far.se).

3.7 Auditors Ordinance (1995: 665)
This ordinance is made up of 18 sections and contains detailed provision for the application of the Auditors Act (2001: 1883) and covers issues such as: approval and authorization, application procedure, directory, certificate on qualification and fees. As a summary this ordinance explains the level of theoretical knowledge and professional competence that one must possess before he/she is appointed or approved by an Authorized Accountant. Other issues involve the fees that an applicant for approval, authorization or registration shall pay.

3.8 The Swedish Company Act (1975)
The globalization of the economy has made many states around the globe to enforce some laws and regulations to control business activities in their territories. The main purpose is to help protect the interest of all those involved in business. The Swedish Companies Act of 1975 covers issues concerning companies or corporations operating in Sweden and this include issues such as the incorporation of a company, share ownership in a company, management of a company and issues relating to Auditing.

3.9 Audit in Small and Medium Enterprise (SME)
SME are considered to be the backbone of the economy development of each nation around the globe and also as an engine of wealth creation and absorber of unemployment.
To grow and expand these entities always seek for additional financial resources from their creditors to ensure their daily operations. And to get access to these funds, they are always required to provide audited financial statements so as to enhance their credibility and assurance. “A transparent financial reporting regime is important for SME to compete to access financial sources and to find partners for their growth development” (UNCTAD, 2002 cited by Dang 2006).

Auditing plays a vital role in small companies. For example in situation where ownership is separated from control, auditing is used as a means to avoid any conflict of interest that may arise between the principal (shareholder) and its agent (manager). Information asymmetry and the demand for monitoring are among the reasons for undertaking external audit (Koh and Woo, 2001, cited by Tabone et al., 2003).

Many companies that qualify for audit exemption continue to have their financial statements audited, just because they want to protect the company’s shareholders, especially those not involved in the management of the company. An audit therefore, brings further benefits which might outweigh the cost of auditing.

Despite the tremendous advantages of small companies acquiring auditing service, it has become a burden to some who cannot sustain the cost of the audit service. Due to this there have been many debates whether to eliminate the function in Small companies because it’s perceived to be costly and since the internal control system of small companies is not as extensive as those of large companies (Chung & Narasimhan, 2001).

SECTION B: SMALL COMPANIES

3.10 Forms of Business

There are many forms of business in the world today and this business can be differentiated taking into consideration different characteristics which give the difference between them. The different forms of business can be classified as sole proprietor, partnership and finally corporation.
a) A *sole proprietor* is a business which is owned and managed by a single individual. He is responsible for all his cost as well as all the benefits of the business. It is the cheapest form of business that has fewer requirements in running the business. Their sources of finance can be from their saving, friends, relatives, borrowing from the banks or financial institutions. Also in case of any insolvency their liability is unlimited as there will be no distinction between their personal and business assets.

b) The *partnership* form of business is a business that is owned and managed from two or more persons. Partnership can be classified as limited and general partnership. The general partnership is also called unlimited partnership. In the general partnership all partners agree on how they will manage and run their business in terms of work, cash, profits and losses. Each of the partners is reliable for the debts of the business and in case of any bankruptcy their liabilities are unlimited. There is a partnership agreement which can either be orally or formally documented. This agreement specifies the terms of the partnership. In case of death or withdrawal of a partner the business is terminated. Not only that but incase of transfer of ownership the partnership is dissolved. While in Limited partnership their liabilities are restricted only to their contribution to the business and no more than that. In terms of managing and running of the business at least one partner may be a general partner or no partner at time participates in managing the business. The limited partner may sell their interest in a business (Ross et al, 1999).

In general, partnership forms of business are inexpensive and easy to form. Some written documents such as licenses and filing fees may be necessary in starting the business. It is difficult for partnership business to raise large amounts of cash to their business as their ability is limited to how much each partner can contribute or they may loan from the banks or financial institutions but they are not allowed to raise funds by selling shares to the general public. Also the difficulty in transferring ownership is a problem with
partnership (Ibid). The partnership business is the largest type of business which is operating in many countries today and with the highest rate of employment.

c) Corporation: Among the other forms of business the corporation is legally distinct from its ownership. In setting a corporate business, articles of incorporation are needed which sets out the purpose of the business, name of corporation, intended life of business, authorized number of shares, limitation and different class and rights of shares, number of board of directors to be appointed, and so on. The corporation can borrow or lend money, it can sue or be sued, it pays its own taxes, there is a separation of ownership and management in the business, shareholders can sell their shares to the public without any effect to their business. In short, there is a lot of advantage in this form of business. Because also the business is a separate legal entity, it is taxed separately (that is the profit of the company is taxed and the dividends of the shareholders are also taxed) (Brealey and Myers (1996). Before going to our main area of interest, it is worthwhile to give an overview on the various forms of companies and how they can raise funds to start or expand their businesses.

From the discussion above one can see that Limited companies are different from sole proprietorships and general partnership form of business especially if we are to use the owner – managed criteria. In the case of sole proprietorship and general partnership it is clearly seen that there is really no need for these companies to prepare and publish their financial statements especially in the case where the cash raised for the business comes from the sole proprietor or the general partners. At this level who then should they report to, when they are the one managing and running their business and already have the necessary information that they need. Asking these types of business to do auditing is not really necessary. But in the case of limited partnership we strongly believe this is necessary since some partners do not part-take in the running and managing of the business and as such they will want to know more about the going concern of the business. So at this point authors believe auditing might be necessary here. The 1985 Companies Act stipulates how this type of business operates.
3.11 European Union (EU) and Companies Act 1985 for Small Companies

In order to reduce cost for certain small financial services companies and also to maintain a certain degree of consumers protection and market confidence and not leaving out financial crime, some measures has been put in place by the EU to alleviate some administrative burden to some small and medium sized enterprises (SME). Thus following the Companies Act of 1985 all companies were required to prepare annual accounts and to have those accounts audited. This requirement originated from the EU directives. That is the fourth council directive on company law of 25th July 1978 (78/660/EEC) which states that all companies covered by these directive should have their financial statement audited by some one who is a qualified professional and the auditor must certify whether or not the financial statement shows a “true and fair view”. (Dewing and Russell, 1999). This directive was also extended to the seventh council directives of 13 June 1983 (83/349/EEC) which deals with companies preparing consolidated financial statements (Ibid). Also Dewing and Russel 2001, explained that the eight directive specified condition as to the approval of persons who are qualified to undertake statutory audits.

According to Chung and Narasimham (2001) the issue of whether or not small companies should be audited has been a subject of debate and also many studies have been carried out in UK and in Australia in relation to this. But in accordance with section 249A and 249AA of the 1985 companies act, small companies do not have to have their accounts audited. The revised fourth and eight directives also gives member states of the EU the exemption of small companies from fulfilling the audit requirement (78/660/EEG; 2006/43/EC). This act was prepared by the United Kingdom (UK) department of Trade and Industry and was approved by the parliament under the auspices of her majesty.

The provision of the act defines the types of companies that can take advantage of accounting and auditing exemptions and those regulated by the financial service and markets act (2000) to take advantage of these exemptions too. The legislation of the act requires all companies to prepare their accounts and have them audited except small companies that meet certain criteria. Under section 246 of the 1985 companies act, small
companies that are qualified for audit exemptions are required to prepare and file their accounts at the Companies House. Section 247 of the act differentiates small companies that are qualified for audit exemptions and those that were excluded from the exemption although they meet the criteria below. Chung and Narasimhan (2001) claim that defining a small company has led to many discussions. For example government departments as well as researchers in Australia generally used statistical criteria such as number of employee, sales turnover and finally assets value as a means of defining small companies. They went further to explain that these problems arise because of the difficulty in determining the appropriate boundaries when using the statistical criteria and the mechanism needed to ensure the adherence of the criteria. However, McCahey (1987) said that the better way of defining small companies is the consistent means of using privacy ownership concept. Because privately owned companies do experience substantial costs from the financial reports requirements and most owner – managers and financial institutions are mostly the sole users of financial information. Tabone and Baldacchino (2003), are of the opinion that the conventional focus when the need for statutory audit requirement is evaluated is by using the economic size of the company that is using the quantitative criteria based on turnover, net assets and number of employees are used to differentiate between small and large companies. According to Tabone and Baldacchino (2003) a classification based on economic size is rather too limited in scope and think it is necessary to consider other indicators such as the ownership – management structure of the companies because it is more stable over time and less sensitive to economic pressure and other external influences than the economic size. From the different articles read, it is true that the definition of small companies is really a problem as different authors are given different economic sizes in relation to the criteria measuring small firm. Bose, 1979 cited by Chung and Narasimhan (2001) that in UK most small companies are those whose turnover does not exceed £1.3million, balance sheet total of less than £0.65 or who have less than 50 employees. Davison (1979) cited by Ibid, also proposed the definition of small companies as those with less than 200 employees and less than £1 million in net assets.
According to Leocher (2000) SMEs which are considered as the engine in every capitalist economy system have been defined in many different ways by researchers in different countries and organizations around the world based on certain criteria or indicators such as “profit, invested capital, balance sheet total, earnings, total capital, sales volume and number of employees (Haake, 1987; Theite, (1999), cited by Leocher, 2000). According to Prohl and Kellerwessed cited by Leocher 2000, small and medium sized enterprises are divided or classified based on quantitative and qualitative criteria. Other researchers such as Clements et al, 1977 cited by Leocher, 2000 defined SMEs as companies in all sectors, including crafts and skilled trades, so long as a given size threshold is not exceeded”.

Following Section 247 of the company act of 1985 to qualify as a small company a company must meet two of the following criteria:

- Its turnover for the financial year should not exceed £5.6million;
- Its balance sheet total for the year should not be more than £2.8million and
- It has not more than 50 employees.

While section 249A of the same company act of 1985 states that a company is exempt from the requirement to have its accounts for the financial year audited if it meet all three of the following criteria:

- It qualifies as a small company in relation to that year,
- its yearly turnover in that year is not more than £5.6million, and
- A total balance sheet total for that year is not more than £2.8 million. (Valerie.Carpenter@dti.gsi.gov.uk).

According to Pichler et al., 1996, cited by Leocher, 2000, the standardized EU definition of SME are those companies that have:

- Less than 250 workers
- A maximum of 40 million euro of annual turnover
- A maximum of 27 million euro annual balance sheet total.

And if any of the above criteria of the SME exceeded the stated figure, the EU will no longer classify the company as a SME but rather as a large company (Ibid).
Also another definition of the small companies following EU guidelines are Small firms that are exempted from the audit requirement are private limited companies and limited liability companies, which in two consecutive years are not able to exceed two out of the three criteria (78/660/EEG): a balance sheet total of 3.65 million euro, a net turnover of 7.3 million euro and also an average number employees of 50. These criteria are the revised version of a balance sheet total of 4.4 million Euro and a net turnover of 8.8 million Euro (2006/46/EG). This new directives have to be implemented by the member states no later than September 2008.

Despite the fact that certain categories of companies will met the criteria mentioned above, they are still excluded from enjoying the advantage of the accounting and audit exemptions, as stated in sections 247A, 248(2), 249AA(3) and 249B of the 1985 Act. The companies that fall under this category of companies are those that related to financial services and markets Act 2000 (FSMA). They are banking and insurance and investments firms coming under the investment service directives.

(Valerie.Carpenter@dti.gsi.gov.uk).

3.12 Importance of the New Proposal

With the high level of competition fuelled by globalization has led many business organizations around the globe to abandon certain of their activities so as to reduce cost and remain competitive. Following the high audit fee incurred by companies in the preparation and auditing of their financial information, many governments have exempt small limited companies in countries such as in USA, Canada and Europe to enjoy the benefit of the administrative burden for small companies in preparing and auditing their financial information.

According to the Financial Service Authority (FSA) the audit requirement will cost small companies about £10.1million and £15.5 million annually and this will put these companies in a disadvantage situation towards their competitors (FSA) and that auditing accounts will provide some benefits by reducing financial crime and enhancing
confidence in markets (www.fsa.gov.uk). This is to show that money saved from audit exemption could be invested by these companies in other activities that could guarantee more income to them. Though, the primary importance of the new proposal will be to reduce the “administrative burden” of these companies. Due to this, the Swedish parliament also tabled a proposal to exempt small limited companies from the statutory audit to enable them benefit also from this administrative cost.

As stipulated by the revised eight and fourth directives of EU, member states are required to exempt small companies from a mandatory audit if the companies exceed certain size criteria as already mentioned above (78/660/EEG; 2006/43/EC). Due to this, the Swedish government has also made a proposal with regards to small limited liabilities companies that will also be exempted from the audit requirement provided these firms meet the EU size criteria for mandatory audits for them to be exempted from the audit requirement but the problem which is unclear is where the threshold will be set. That is the size criteria, which is the turnover, balance sheet total and number of employees. Thus the abolition of statutory audit will mean a change particular to small firms, audit firms, investors, lenders (banks) as well as society in general. Due to this situation we decided to carry out investigation focusing on one stakeholder which is bank.

SECTION C: BANKING

3.13 The Banking Sector
The success of every economy and business around the globe depends on the banking sector (www.ceres.org), since banks are considered as providers of funds to organizations that are in difficulties in raising funds. The survival of small business therefore depends on banks for their financial needs and other services (Meyer, 1998).

There is no fixed definition of a bank as we can see below from the definitions by different authors. A bank is defined as “an organization usually a corporation chartered by a state or federal government which does most or all of the following: - receives demand deposits and time deposits, honors instruments drawn on them and pays interest
on them, discounts notes, makes loans and invests in securities, collects, checks, drafts, notes certifies depositor’s checks and issue drafts and cahiers checks” (www.investorswords.com/401/banks.html). A bank as defined by the Cambridge Advanced Learner’s Dictionary is “an organization where people and businesses can invest or borrow money, change money to foreign money, etc., or a building where these services are offered”. Another definition of a bank is an establishment where money is kept for either saving, commercial purpose, invested, supplied for loans, exchanged etc., or the building or offices in which such entity is located (www.answers.com). The banking sector is characterized by different types of banks such as commercial banks, savings bank, corporate banks and investments banks, just to name a few. The main function of these banks is to receive deposits from customers and also the issuance of loans to individuals or companies. The banking sector varies from country to country. We are going to give a brief description of the Swedish banking system.

§The Swedish Financial market is made up of three largest groups namely the banks, housing and finance institutions though there are also important players in the market like the mutual fund companies, fonderstate administered (AP) Funds. Among all these players of the financial market in Sweden we shall focus only on the banking sector. (www.bankforeningen.se). The bank structure in Sweden is categorised under four main categories, they are bank companies, foreign banks, savings banks and operative banks.

During 2006 there were a total of 127 banks in Sweden and from the beginning of 1990s the number of commercial banks and foreign banks in Sweden has increased drastically from 15 to 50. Reason for this increase is because of the entry of niche banks, transformation of savings banks/building societies into bank companies as well as the establishment of foreign banks.

The Swedish bank companies are made up of four large banks – Swedbank, Handelsbanken, Nordea Bank and finally SEB. These banks account for 75 percent of the total market. In addition to these large banks there are also small bank companies with different ownership and specializing in various activities and different ownership
structures. Banks that fall under this category are saving banks that have been transformed into bank companies with Swedbank as part-owner. While other Swedish banks concentrate on private customers market and also provide their services through the internet and also by the means of telephone. They are known as niche banks. Some newly created banks are ICA Banken, Resurs Bank and Forex bank (www.bankforeningen.se).

Another category of banks is the foreign banks which mainly have subsidiaries in Sweden. They were allowed to open branch offices in Sweden in 1990 and in the beginning of 2006 there were 28 foreign banks in Sweden, with the majority of them gearing towards the corporate banking and securities markets. As for now the largest foreign bank is Danske Bank which is classified as the fifth bank in Sweden after the largest four banks. The saving banks are approximately 70 in number and are independent. Normally, they are small and operate in regional or local markets. Whereas, cooperative banks are created purposely to conduct banking business for the benefit of members (www.bankforeningen.se.) Below is a table showing the statistics of number of banks in Sweden in year 2000 and 2003.

<table>
<thead>
<tr>
<th>Types of Bank</th>
<th>2000 (December)</th>
<th>2003 (December)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Swedish Commercial Banks</td>
<td>22</td>
<td>27</td>
</tr>
<tr>
<td>▪ The big four</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>▪ Other Swedish commercial banks</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>▪ Former saving banks</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>21</td>
<td>22</td>
</tr>
<tr>
<td>▪ Subsidiaries</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>▪ Branches</td>
<td>19</td>
<td>20</td>
</tr>
<tr>
<td>Savings banks</td>
<td>79</td>
<td>76</td>
</tr>
<tr>
<td>Cooperative banks</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>124</td>
<td>127</td>
</tr>
</tbody>
</table>

Sources: The Swedish Financial Supervisory Authority (finansinspektionen).
These banks are under the authority and supervision of the Sveriges Riksbanks known as the Sweden’s Central Bank, which main function is to conduct and monitor the monetary policy and fight against inflation as to maintain an acceptable low level and to secure that all payments are made in the economy (www.riksbanks.com). The Swedish banking sector was deregulated in mid 1980s by the risks banks (central bank) in which banks were called upon to limit the amount of their loan portfolio. This enable the banking sector to be highly competitive and internationalized, which therefore led many local banks operating in Sweden to establish offices abroad (Battese et al, 2000). The Swedish banking sector has been evolved over the past decade. The evolution is characterized by a diversification from banking to insurance operations. Another important change in this sector is the massive use of internet and telephone where customers can carry out their transactions with their banks without going over the counter (www.bankforeningen.se).

In Sweden, there is also a Swedish Bankers Association which is formed by the banks in Sweden to inform the population about the banks and their positions in the society. The association membership is made up of banks, foreign banks operating in Sweden, finance companies and mortgage credit institutions within the banking sector. The Swedish banking Association is made up of 32 members companies of which there are 22 banks, 5 Finance companies, and 5 credit institutions. It is run and managed by the banking assembly which meets annually to elect the board members.

The primarily roles of the association are:

- To help member companies in matter of common interest;
- To act as referral body and negotiate art in matters of importance to the member companies;
- To represent the member companies internationally mainly in the European banking federation and
- To inform external organizations and individual about conditions on the credit market (www.bankforeningen.se)
CHAPTER FOUR

EMPIRICAL FINDINGS

Our empirical framework consist of three respondents all of them working among the four main banks in the Swedish market. We decided to summarize the interview following the structure of the interview manual which was split into three sections. Section A deals with Background of respondents and areas of study, section B deals with question before the proposal and finally section C tackles the questions raised after the proposal is made.

SECTION A

4.1 Background of the respondents

Respondent A, is working as a Relationship Manager with Company “A” and is in-charge of mid-size companies. He is a holder of a Bachelor of Science (B.Sc) degree in Business Administration and Economics from Umea School of Business and Economics (USBE). He has been working for the past six and the half years and during these periods he had worked in two different banks but working in similar positions. He had worked with Nordea bank for six years before moving to Company “A” where he worked for 5 months.

Respondent B, whom we interviewed at Company “B” is the branch manager. In terms of academic qualifications, he is a holder of a high school certificate in Economics but has a sound working knowledge with a work experience of 21 years tapped from different banks and branches around Sweden.

Respondent C is working with Company “C” and is a holder of a Masters degree in Accounting and Finance and has been working as the Corporate Adviser for over one year with the same company.
4.2. Background of Study Area

Following our area of Study we carried out our interview in three different banks as shown below.

The first respondent that we interviewed worked in a bank that was formed in 1820 and is one of the major commercial banks in the Swedish banking market. The bank was listed on the Stockholm stock exchange in 1995. It is now operating in Sweden with 459 branches and has established abroad with 299 branches in the Baltic States and 190 in Ukraine.

The bank deals with private as well as corporate customers. It has a total of 9 Million private customers and 500,000 corporate customers. The bank’s vision is to be a key player in the markets in which it operates and this leading position made the bank to be highly profitable with a profit of about SEK 11.996 million in 2007. Its financial objective is to maintain a sustainable growth in earnings per share exceeding the average of the peer group (annual report 2007).

The second respondent is from one of the leading Nordic commercial banks in the banking sector created in 1871 with a capital base worth 75 billion Swedish Kronor (SEK). The bank is operating locally in Sweden with 460 branches and this has made the institution to hold a strong position in the Nordic countries. It has also extended its operations abroad with branches in over 20 countries around the globe. The bank’s objective is to achieve a higher profitability and more satisfied customers than its competitors and therefore this has made the bank to provide a high quality banking service to its private and corporate customers. They offer services such as private banking, corporate banking, property mortgage as well as life insurance and trading.

Finally, the last respondent which we interviewed worked in a bank that traces its roots as far back as 187 years. The name of the bank was formed from a combination of two words, “Nordic” and “idea”. The bank originates from four Nordic banks: Merita bank, Nordbanken, Unibank and Christiania bank from Finland, Sweden, Denmark and
Norway. It has over 1300 branches office with 32,000 employees and operates with a total asset of about 411 billion euro and provides internet banking and e-commerce operations with over 4.1million customers. This has made the bank to be the leader in the banking sector in the Nordic and Baltic sea region (Estonia, Latvia, Lithuania, Poland and Russia). Its shares are listed in Stockholm, Helsinki and Copenhagen. The bank vision is to be the leading Nordic bank by creating superior value for customers and shareholders.

SECTION B

In this section we focused on questions relating to the new proposal that was made prior to its creation.

How do you define small firms

According to respondent A, the definition of small firms is based on the bank’s perspective and he states that small firms in the northern part of Sweden are those that have a turnover of less than 10 million Swedish Kronor (SEK) and less than 5 employees. He also added that the company’s loans are less than 3 million sek.

Respondent B stated that they do not have a particular definition of small firms because it depends on which market they operate in. Since a small company in Skelleftea can be a big company elsewhere but he added that with Skelleftea standard, a small company is one that has a turnover less than 20 millions SEK and less than 20 employees.

Here respondent C stated that they do not have a specific definition of small companies. According to him a small firm is one that has less than 50 employees. He added that they take into consideration criteria such as turnover and the balance sheet total when defining small companies.

Loans to small firms

The entire respondents accepted that they loan money to small companies. With the exception of respondent A, who added that they loan more money to small companies
than even the other banks in the banking market in Sweden and also deals with many small firms.

**What are the requirements (criteria) to issue Loans to Small Firms (companies?)**

Respondent A, stated that in order for the banks to issue loan to small companies, they required the companies to present their accounts for the previous years that is forecast budget, cash flows and be able to ascertain how they want to use the money. The bank uses this to assess the ability of the firm to payback their loans. He added that to secure any loan the firm will guarantee 20 to 25 percent if the investment of the loan is 1million SEK. The firm can also guarantee his building/house or loan money from Risk Financial Bank as collateral.

When asked about the interest rate that the bank charges on Loan, the respondent stated clearly that the bank charges interest rate based on the banks model by estimating the risk of insolvency in each company and therefore calculate the “expected loss” and charges interest rate to reach the bank’s goal for Return on Equity “after the expected loss”. He also stated that interest rate depends on the quality of a firm’s accounts or financial situation. A firm’s accounts that lead to lower expected loss will be charged low interest rate.

While respondent B, stated that the bank has the same requirements and criteria to issue loan no matter the sizes of companies and went further to add that their main concern is to look upon the customer ability to pay back the loan through the presentation of their financial statements. When he was asked if the bank does not take into consideration collateral securities and interest rate when issuing loan to the company, he stated that the bank has two steps in evaluating a customer. The first step consist of analyzing the company ability to payback the loan through its financial report and if the bank realizes that the company is able to pay the loan it will then go to the next step by looking at the company’s securities that the bank will get for the loan. He also mentioned that if a company does not fulfill the first step then the bank will no longer be interested in the securities and the company will not be qualified for any loan.
Concerning interest rate, he stated that the bank applies interest rate based on the risk as the higher the risk, the higher the interest rate that will be charged. In addition, he mentioned that the bank does not apply a time valuation of the interest rate and that interest rate are fixed for identical loans.

Also respondent C answered this question by saying that the requirements to issue loan to small companies are similar with those of bigger companies. He added that when issuing loans, the bank always take into consideration if the company has sufficient cash flow as a guarantee to pay back the loan. The bank also takes into account some collateral securities such as building and in some cases the bank may hold the owner of the company responsible if the company is not able to fulfill its payments.

Concerning interest rate, he stated that interest rate foremost is charged depending on the project’s risk, amount of the loan, the size of the company and the purpose of the loan. He also mentioned that they try to match the right time of the object with the payback period. He concluded that they generally charge a fixed interest rate on loans.

Are there any criteria for small firms to borrow from the local branches as opposed to the regional office?

As stated by the respondents A and C, there is no criterion for small firms to borrow from the local branches as opposed to the regional office since both the local branches and the regional office have same criteria when it comes to lending money to small companies.

Contrarily, respondent B stated that in their bank they don’t have that type of arrangement as only the local branches do business with their customers. He mentioned that the regional office has a staff function that supports the local branches.

How do you fight against the risk of insolvency from Small Firms?

In order to fight against the risk of insolvency, respondent A answered that the bank does a follow-up of the company’s account for the previous years and if they are not good the
bank will further require the company to present its forecast budget and that the owners should be the guarantor of the company. He also added that the bank does not loan money to a company if they do not have up-to-date statements of its activities and when they do not believe in the owner’s capacity of running (managing) the business.

Respondent B explained that to prevent customers from ending up in bankruptcy, the bank tries to have a closed connection or relationship with customers, so that customers can always inform the bank anytime they are in trouble so that both of them can see how they can manage the situation in order to save the company from bankruptcy. Furthermore, he said that if the bank has realized that a company is not doing well from its financial statements, then the bank goes to the company and requests for financial statements every three months in order to follow-up the progress of the company.

Respondent C mentioned that to fight against insolvency they try to make a good judgment as far as possible about the risk of the business and stated that the risk varies between businesses and that they also look at the company’s collateral securities. Concerning risk measurement, he stated that the bank does not have any exact measurement. They used experience through statistics and look at the company history by taking into consideration documents such as the company’s financial statements.

**What modality do you use to assess the risk of different firms?**

Here respondent A answered that the bank’s main office makes their assessment of the different industries and that they rely on the owners trust. Respondents B and C indicated that this question was already addressed in the question 3.

**How do you monitor a small firm’s project financed by the bank**

Respondent A answered that it’s difficult for the bank to monitor small firm’s project that is being financed by the bank but the bank does a follow up of the company’s previous accounts each year.
Respondent B indicated that to monitor small firm’s project that is financed by the bank, the bank has a closed relationship with its customers and that there must be an open dialogue between the bank and its customers.

Respondent C mentioned that they always look at the financial statements at least once a year to see how the company is doing. If they realize that a company is in trouble, they make a regular contact with the owner to see what is going on.

**What do you think about the importance of Auditing**
When asked about the importance of auditing which is the main concern of the topic, Respondent A, acknowledged that according to him auditing is very important and that the main importance of auditing is quality or credibility because if accounts are not audited the quality of the material will be worse.

While respondent B said that the importance of auditing depends on the type of company that one is dealing with. He went further to explain that with a company having a good economic department headed by qualified professionals, auditing does not make any difference since all the figures produced by the company are correct in the way that they are supposed to be. But that with a company that the owner does not have an understanding of figures then he thinks auditing is important, since it gives both the owner and the bank a certain sort of control or credibility.

On his part, Respondent C stated that in his perspective, auditing is very important as it gives high trust/credibility in a company’s financial statements.

**Reliability on the trust/assurance of the company Financial Statements**
Concerning the reliability on the trust/assurance of the company’s financial statements, the respondent A answered that the bank relies on the trust of a company’s financial statements differently between companies and that for example the banks needs from a good company its financial statements that is audited and does not need a financial statements from a bad company.
According to respondent B, they rely quite a lot on the financial statements of companies since all the companies are now required to have their accounts audited and went further to explain that they trust accountants to be good auditors. He also added that on the other hand the law gives freedom on how to value items such as asset and that without going out of the law company’s cannot make their figures better or worse than reality. That from his experience as a banker for over 20 years, companies that show bad figures, the reality is almost worse and a company that shows good figures, the reality is always better in the future since good companies always try to keep their figures down to avoid tax while a bad company always try to increase its figures not to loss credibility.

Respondent C mentioned that they rely on the trust/assurance of company financial statements when they are being audited.

SECTION C
This section deals with questions after the new proposal was made.

How do you define small firms after the new proposal
Respondent A, says that he does not have any idea about the definition of a small firm after the new proposal.

Here, respondent B, stated that their view of defining small firms will not change after when the new proposal will be in effect because according to him they don’t see any interest in defining small or large firms and went further to say he did not have any idea about the economic size of a small firm as defined by the new proposal in terms of turnovers, balance sheet total and number of employees.

Respondent C, stated that he does not know the exact definition of a small company when the proposal will come through but that he is aware of the proposal definition of small companies in terms of turnover, number of employees and balance sheet total but not
aware of the figures. According to him, a small firm is one that has less than 50 employees.

**Are you aware of the new proposal by the Swedish parliaments regarding SME to not audit their accounts**

So far as this question is concerned, all the three respondents do agree that they are aware about the new proposal about the audit exemption of SME in Sweden.

**Reactions to the new proposal by parliament regarding SME demand for auditing**

On the question of reactions, respondent A said that with this new proposal, they will have a worse material for their assessment no matter the argument that the proposal will reduce bureaucracy for customers.

Respondent B, stated that when the proposal will come through, it will develop different standards from what they have today and that there will be some sort of standard that will work out together with the auditing firms because in some companies it will not be necessary for their accounts to be audited by a certified auditor and he stated that this can be done by a good book-keeper. But that the financial departments of these companies will develop a new standard that will permit the bank and the companies to speak the same language. He went further to say that when issuing loans, they will make an agreement with their customers to produce their financial statement in a certain standard and that customers should go and tell their book-keeper that the bank wants them to prepare their financial statement in this standard and the audit firms should be aware of the standard that are proposed to companies. He also stated there will be different level of auditing in companies that will not be necessarily carried out by certified auditors. Finally, he stated that some companies can deliver their financial statements and if the bank has trust in their financial department, then the bank will deal individually with customers depending on how they know each customer.

According to Respondent C, the new proposal regarding SME demand for auditing is reasonable, since today many of the small firms incurred quite a higher cost for their
accounts to be audited. But on the other hand, he holds the view that this also has some severe effects particularly regarding the aspect when it comes to borrowing money from the bank as the bank will prefer a Financial statement that has been audited to the one that is not audited because of the importance of trust and credibility that is attached when an account is audited.

**Will you demand SME to have their accounts audited? Why and Why not?**

Respondent A said yes that SME must have their accounts audited if they want to apply for loan in some cases. When asked why they will demand small companies to have their accounts audited, he answered that the bank will demand an audit from a small company in the case where the quality of the company’s financial statements is not as good as what the bank requires. He also stated that the bank will demand for an audit in a case where the company wants to apply for a big loan.

In his own opinion, respondent B says they will not demand SME to audit their accounts generally. But that with SME, the bank will exempt from auditing those that the bank has trust in. While those they don’t have trust in, they would require them to have their accounts audited.

Here respondent C mentioned that the bank does not have any official statement about this but that *probably* they will need some kind of appreciation (authorization) of auditing that can be in the form of book-keeping or from a firm that has some kind of authorization and not necessarily from an auditor.

**How will you rely on the trust/assurance of the company Financial Statements following the new proposal?**

Respondent A mentioned that he does not know any thing concerning this yet but that it will probably be different between customers and went further to explain that the bank has not yet decided on how it will deal with this issue.
Regarding the issue of trust/assurance, respondent B said that the trust in a company’s financial statement is based on a relationship between the bank and the customer and that since the bank and the customers have been working together for a long time, the bank has had the possibility to experience both the development of these companies and their financial material that they delivered.

As stated by respondent C, it will be difficult for them to trust in companies that will not audit their financial statements. They can trust financial statements if only they are audited by an authorized person such as book-keeper and not necessarily by a certified auditor.

**How do you then monitor a small firm’s project financed by the banks**

Respondents A and C pointed out that their bank had not yet opted for this but that it will be the same like before the proposal and that the bank will ask customers to present their accounts for previous years, that is their cash flows and forecast budget.

Respondent B stated that when the new proposal will come to effect, they will monitor small firms project that is financed by the bank by visiting the small firms to see if the money borrowed by the firm has been properly used by looking at the machines and stock if they are really there.

**Do you see the new proposal as a hindrance between the bank and small firm’s customer relationship?**

Respondents A and B said they do not see any hindrance in the relationship between the bank and the customers when the new proposal will come through and that they consider the new proposal as something that will strengthen the relationship between the banks and customers since they will be dealing with customers through a dialogue about what standard of financial statement should be produced by them.
While respondent C stated that it will be difficult to know how the bank reactions will affect the relationship between the bank and customer’s but concluded that this will definitely be a potential problem.

**If the statutory audit is removed, do you then see any increase in economic crime**

Respondent A said he does not have an answer as far as this question is concerned.

Respondent B stated that at their bank they do not see any increase in economic crime since they know or understand their customers very well and he thinks the tax authorities will definitely set-up tax auditing in order to prevent fraud.

Respondent C accepted that there will be a risk of an increase in economic crime and this will depend in the sense that loans will be given only to those that can prove that their financial statements are audited.

**The information that you get from an auditor, how would you get it if the statutory audit are now removed? Do you think a different strategy should be implemented**

Respondent A said that nothing had been decided yet in relation to this question.

Respondent B stated that there will be no strategy. But that he thinks if they will make an agreement with customers to deliver their financial statements according to a standard known by the bank and audit firms about the type of financial information that is supposed to contain, it will then be analyzed in the same way as before.

When asked about the type of standard required by the bank, he mentioned that there will be a discussion between the banking association and audit firms about the type of standard that every customer should use in preparing their financial statements.

Respondent C stated that they will still require a certain type of authorized financial statements before they can issue loans.
Do you think that the quality of the accounting will be inferior or superior now if the company compiles itself to external help e.g. booking agency or accountancy?

Respondent B stated that he thinks the quality of the accounting perhaps in some cases will be inferior because many small companies will see this as a means to save money, since today they have to pay money for an audit whether they like it or not: He also mentioned that on the other hand he thinks this will be a problem that will not last for long because he thinks companies that will try to use cheapest means to prepare their financial statement (reports) will meet trouble wherever they go and that this will enable them to raise the quality of their financial statements. Furthermore, he stated that they will not trust any bookkeeping firm that delivers poor quality and will inform their customers of not using the services of this type of bookkeeping firms and every customer must use a bookkeeping firm that is known by the bank.

While respondents A and C stated that accounting will be of lower quality since the companies will not have the same expertise and knowledge as the book-keeper and auditing firm.

**Will you think of developing a new research about the present situation or issue to tackle this situation**

All the respondents mentioned that they do not think of developing a new research. To conclude respondent B said he is not worried about the new proposal because for him this will create possibilities for auditors to offer full non-audit services such as consultancy and this also will permit a closer relationship between the bank and its customers.
CHAPTER FIVE

DATA ANALYSIS AND INTERPRETATION

Making our analysis and interpretation from the findings which we gathered from the primary source of data, we interviewed three respondents from three different banks and as mentioned earlier within the text, we decided to split our questionnaire into three parts. But for the analysis and interpretation of our data, we shall focus more on sections B and C, which we think can help us provide answers to our research questions. At this juncture, it would be worthwhile to remind the readers about our research questions. *What is the banks opinion about the New Legislation removing statutory auditing for small companies? What will be the reaction of the banks if small company’s accounts are not audited and how are they going to restore trust/assurance over the Financial Statements of the small companies?*

5.1 Banks Opinion on the New Legislation Removing Statutory Auditing

Answering these questions we started with section B where all the respondents we interviewed from the different banks acknowledged the fact that auditing is very important as far as quality, trust and credibility of companies financial statements are concerned. Since the banks rely quite a lot on the company’s financial statements when making their economic decisions as of now they said they do not have any problem with small companies financial statements since all firms are compelled by law to have their accounts audited. They trust company’s account because they are audited by qualified accountant (auditor) and their assets are valued in accordance with the standard stipulated by the law.

Therefore, their opinion regarding the new legislation to remove statutory auditing for small companies is perfectly okay since it reduces the administrative burden for small companies to have their accounts audited by a certified accountant. Though they supported this idea but they had these to say. Respondent A thinks that eliminating the administrative burden for SME is good but fears they will have the worse material in
terms of quality when it comes to assessing company’s financial statements. While respondent B states that when the new proposal will come into effect it will develop a different standard from what they have today. He thought the banks together with the auditing firms will draw out a certain standard that the banks will want companies to implement, which will not necessarily warrant the company’s accounts to be audited by a certified accountant as this can be done even by an authorized or qualified book-keeper provided they prepare their accounts in accordance with the standard required by banks. He also added that the financial departments of those companies will have to develop a new standard that will enable both the bank and the company to speak the same language. So in his opinion he sees nothing bad with the new proposal. But when it comes to making economic decisions regarding issuing of loans to small companies the importance of auditing will now depend on the type of company that one is dealing with. Respondent B is of the opinion that companies who have a good economic department that is headed by well qualified professionals will not make any difference to him since the figures produced by the company will be correct as they were supposed to be prepared following the normal standards. But in the case where the owner as well as the economic department is not having a good understanding of the figures then auditing is very important both to the firm as well as the banks to give a certain degree of control and credibility in the company’s financial statements. Auditing or no auditing does not matter. It all depends on the trust that the bank will attach to the individual customers depending now, on how well they know each customer. Finally, according to respondent C the reaction is reasonable because today many small firms incur huge costs for their accounts to be audited. But when it will come to lending money to those small companies, he thinks the bank will prefer a financial statement that will be audited than one that is not audited because of the importance of trust and credibility that is attached when accounts are audited but also not necessarily from a certified accountant.

5.2 Banks reaction when SME accounts will not be audited.

The part that the banks play with SME accounts is when it comes to borrowing (lending) money. As such, as for now all the respondents agree that they do not have any problem with the small companies account in order to issue loans to them because presently the
law requires all companies to have their accounts audited. Instead what they look at when issuing loans to companies irrespective of the size are for them to present their accounts of previous years such as forecast budget, cash flows, and how they will want to use the money. Conclusively, what the banks need is the company’s financial statement (reports). Another aspect that banks looked at is the ability to pay back the loan by the companies. They demand the SME to issue collateral security which they used as a guarantee in case the company cannot pay back its loan (bankruptcy). The response from all respondents shows that banks have different modalities for the collateral security as indicated.

Respondent A said to secure any loans; the firm will guarantee 20 to 25 percent of the investments if the loan is 1million, guarantee their building or loan money from Risk Financial Bank to act as a collateral security. Respondent B pointed out that the bank follows two steps when evaluating a customer. The first step involves analyzing the company’s ability to payback the loan through their financial statements. If the customer meets the requirement in the first step then the bank goes to second step which involves looking at the company’s collateral security. Finally, respondent C mentioned that to issue loans no matter the size of the company the requirements are similar. What they need is to verify the financial statements of the company if they have enough cash flows, which will enable the company to pay back their loans and also focus on their collateral security such as building.

Another main issue that all the banks concentrated on when issuing loan is interest rate. They all accepted that banks do charge interest rates which vary between banks. In this regard, respondent A said interest rate is charged by estimating the risk of insolvency (bankruptcy) in each company and based on a calculation of the “expected loss”. This interest rate is charge on the expected loss to reach the bank goal for “return on equity”. Respondent B said for them interest rate is charge based on the risk of the loan. The higher the risk the higher the interest rate and finally respondent C said interest rate is charged depending on the project risk as the amount of the loan, size of the company and purpose of the loan will determine the interest rate to be charged.
However, responding to the question when the new proposal will be implemented into law perhaps by 2010, exempting small companies’ accounts from auditing, these authors (Arrey and Gabsia) asked some banks whether they will demand SME to have their accounts audited though free from auditing by law. The respondents said “Yes and No”. According to Respondent A, SME will be demanded to have their accounts audited if they want to apply for loan. But added that this will be conditional in the sense that they will demand an audit from a small company in the case where the quality of the company’s financial statement is not as good as what the bank requires. But in the case where the loan is also big then the bank will demand for an audit. In the opinion of respondent B they will “not” demand SME to audit their accounts generally. Any SME that the bank will trust will be exempted from auditing when issuing loan. In the case where the bank does not have trust in the company’s financial statements they will demand their accounts to be audited before any loan will be issued. While for respondent C had no answer since their bank had not yet decided on this yet. But went further to say probably the bank will need some kind of appreciation of auditing but not necessarily from a certified accountant (auditor) but even from a qualified book-keeping firm. As a conclusion to this question, respondent’s at-least accepted that they will demand SME to have their accounts audited especially when trust is lacking in the company’s financial statement though not necessarily by a certified accountant. This now take us to the next question highlighting the role of banks going in restoring trust/assurance over F/S that is not audited.

5.3 Restoring trust/assurance over F/S that is not audited
The aspect of restoring trust remains the main issue, as the various respondents had this to share. Respondent A said this will probably be different between customers since the banks had not yet decided on how it will deal with this issue.

Respondent B tackle the question in a logical way using his long working experience by saying that the trust in the company’s F/S will be based on the relationship between the bank and the customer, since the bank had been dealing with some customers for long so
the bank would ascertain the progress of these companies and their financial material that they delivered will enable them to base their trust. He added that since the law gives freedom on how companies value their assets without going out of this, he thinks companies cannot make their figures better or worse than reality. As good companies may try to keep their figures down to avoid tax while bad companies always try to increase their figures in order not to loss credibility. But the tax authority will definitely make more tax auditing in order to prevent fraud and this will help to restore trust to company’s F/S because they expect the tax authority to do their tax auditing perfectly.

While respondent C holds that it will be difficult to trust companies that will not audit their financial statements because the bank will trust F/S only if they are audited. All do agree that they will trust financial statement that is audited but not necessarily by a certified auditor but even an authorized book-keeping firm.
CHAPTER SIX

CONCLUSION AND RECOMMENDATIONS

6.1 Conclusion

Most members of the EU countries have already exempted small companies from compulsory statutory auditing, but in Sweden this is still a new proposal that is under debate by the parliaments and this will be in effect in 2010. Before writing this thesis we thought banks are going to have a negative thought towards the new legislation, but this became a nightmare to us after carrying out the interview from the banks. We came to realized that the banks are of the opinion of accepting the removal of statutory auditing to the small companies because of the administrative burden cost that the small companies incurred during auditing especially using a certified accountant (auditor).

In expectation of how banks are going to react because of the importance that statutory audit attaches to company’s financial statement, the knowledge gained from existing literature and from interview, it is understood that though the government is exempting auditing from small companies on the pretext of administrative burden, statutory audit still plays a vital role to third parties such as banks, tax authorities and trade creditors who have no direct ownership interest in the business but who use the financial statements when making economic decisions. Not only this but also statutory audit is vital when it comes to owner-manager and staff. It also helps to reduce errors and fraud that could be committed by the employees either voluntarily or by error, which could not be realized by the owner especially if he lacks the expertise. Therefore, for the small companies to be free from statutory auditing and the administrative burden cost this will work perfectly if the small companies can survive without third parties as nobody will then demand them to have their accounts audited.

From the study, we also realize that banks don’t have an idea about the economic size of small companies as stipulated by the new legislation taking into account the number of employees, balance asset total and turnover of the company. For them the economic size does not matter because it is not considered when granting loans to companies. To
conclude, we are cognizant that undertaking this research has been worthwhile as we now have a wider knowledge and a deeper understanding of the subject. Based on literature reviewed and the interviews carried out, we attempted to provide some answers within the remit of our research, in line with the research questions and purpose of study.

6.2 Recommendations
With the importance that auditing attaches on financial statement by restoring assurance and credibility, therefore, we recommend that instead of removing statutory auditing completely for small companies the government should negotiate with auditors on how to reduce cost for those small companies so that the administrative burden will be reduced while maintaining quality in the financial statement through assurance and credibility.

Furthermore, since small companies cannot sell their shares nor borrow to the public in order for them to raise capital for the smooth running of their business their main source of which they can survive financially is by borrowing money from the banks. Taking into consideration the information that we gathered from the banks when it comes to borrowing money to small companies we are suggesting to banks (through the banking association) to form a standardized lending decisions which will enable all the banks to speak the same language and avoid conflict between them and their customers because of individual discretion that may guide its implementation by different banks managers which may affect banks and customers relationship. A possible scenario may be bank A refusing a customer while bank B accepts that same customer as there is no standardized regulatory mechanism.

6.3 Further Research
Since there are other third parties (banks, tax authority employees and trade creditors etc) to company’s financial statements, we shall recommend that a further study should be carried out on trade creditors to have their own opinion regarding reactions about the new proposal or legislation concerning small companies in Sweden that will be exempted from statutory auditing.
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Appendix I

Questionnaire

The question will be divided into three sections. Section “A” Personal and Background of the banks. Section “B” questions before the new proposal was made and Section C question after the new proposal is made.

Section A

Personal Information
1. Name
2. Position
3. Qualification
4. Working Experience

Background of Study Area
1. Name of institution
2. Date of creation
3. Location
4. Capital
5. Number of branches

Section B

Before the New Proposal:
1. How do you define small firms?
2. Do you loan money to small firms?
3. What are the requirements to issue loans to small firms?
4. Are there any criteria for small firms to borrow from the local branches as oppose to the regional office?
5. How do you fight against the risk of insolvency from small firms?
6. What modality do you use to assess the risk of different firms?
7. How does the bank charge interest rate to cover risk and cost?
8. How do you then monitor a small firm’s project financed by the banks?

9. What do you think about the importance of auditing?

10. How did you rely on the trust/assurance of the company Financial Statements?

Section C

After the New Proposal

1. How do you define small firms?

2. Are you aware of the new proposal by the parliaments that require Small firms to not audit their accounts?

3. What is your reaction to the new proposal by the parliaments regarding SME demand for auditing?

4. Will you demand SME to have their accounts audited? Why and Why not?

5. How will you rely on the trust/assurance of the company Financial Statements following the new proposal?

6. How do you then monitor a small firm’s project financed by the banks?

7. Do you see the new proposal as a hindrance between the bank and small firms customer relationship?

8. If the statutory audit is removed do you then see any increase in the economic crime?

9. The information that you get from auditor, how would you get if the statutory audit are now removed? Do you think to implement a different strategy?

10. Do you think that the quality of the accounting will be inferior or superior now if the company compiles itself to external help e.g. booking agency or accountancy firms?

11. Will you think of developing a new research about the present situation or issue to tackle this?