



School of Economics
and Commercial Law
GÖTEBORG UNIVERSITY

Department of Business Administration

THE DIVISION OF AUDIT & NON- AUDIT SERVICES

**- AN INVESTIGATION OF THE EFFECTS OF SECTION 201
of the Sarbanes-Oxley Act on the Activities of Swedish
AUDITING FIRMS.**

BACHELOR THESIS
ACCOUNTING AND FINANCE
SPRING 2004
TUTOR: MARCIA HALVORSEN
AUTHORS: ANETTE KARLSSON, 820305
MARIA-PIA SJÖBERG, 790501

Abstract

Bachelor degree in Business Administration, School of Economics and Commercial Law at the Göteborg University, Accounting and Finance, Bachelor thesis, Spring 2004

Authors: Anette Karlsson and Maria-Pia Sjöberg

Tutor: Marcia Halvorsen

Title: The Division of Audit & Non-Audit Services – An investigation of the Effects of Section 201 of the Sarbanes-Oxley Act on the Activities of Swedish Auditing Firms

Background and problem: As a response to recent corporate scandals, a new law, the Sarbanes-Oxley Act, was passed in the United States on July 30, 2002. The law applies to all companies, American as well as foreign, that are listed on American stock exchanges. The auditors of companies that are located in Sweden but are affected by the Act must therefore adjust to the new rules. Section 201 of the Act prohibits an auditing firm from providing an audit client with certain non-audit services. Since most firms offer both audit and non-audit services and often perform both kinds of services to their clients, the regulations of Section 201 will have impact on the activities of Swedish auditing firms.

Purpose: The purpose of this research is to describe the effects that the division between audit and non-audit services in Section 201 of the Sarbanes-Oxley Act will have on the activities of Swedish auditing firms. This is to be done by analyzing how the auditing market and auditing firms adapt to the new regulations. It is also our aim to increase knowledge of the importance, applicability and the implementation of Section 201 of the Sarbanes-Oxley Act.

Delimitations: Because most Swedish companies and Swedish subsidiaries of foreign companies that are affected by the law are audited by one of the major four auditing firms (KPMG, Ernst & Young, PricewaterhouseCoopers and Deloitte), the thesis is written from their point of view. Therefore we only find it relevant to interview representatives of the Big Four. It is also important to remember that the effects that Section 201 of the Sarbanes-Oxley Act have on the affected companies lies outside the scope of the thesis.

Methodology: The thesis is based on personal in-depth interviews with Swedish representatives of the Big Four auditing firms. In addition to these interviews, four short interviews have been carried out with persons that are connected to the issue. The thesis is of a qualitative character and has a descriptive and an explanatory approach.

Results and conclusions: We have drawn the conclusion that Section 201 of the Sarbanes-Oxley Act will not have great effects on the activities of Swedish auditing firms. However, there are areas that are likely to be affected, indirectly, by the demand for division between audit and non-audit services. We are of the opinion that audit fees may increase while non-audit fees may decrease. The prohibited services may increase the appearance that the auditing firms are independent and we also believe that the competition on the market for non-audit services may toughen. Also, the impact of Section 201 may increase if the proposal for a new EU Directive on statutory audit is passed.

Suggestions for further research: This thesis is written from the auditors' point of view. It would, therefore, be of great interest to investigate what effects the regulations of Section 201 will have on the Swedish companies that are affected by the Act.

ACKNOWLEDGEMENTS

The process of writing this thesis has been a challenge. It has taught us much, about the subject as well as about ourselves. We would, however, not have been able to write this thesis without help from the following persons:

First, we would like to express our gratitude to the representatives of the Big Four: Peter Åkersten, Michael Bernhardt, Olof Herolf and Helena Herlogsson. Thank you for taking the time to answer our question, sometimes with great patience.

We would also like to thank Tord Jonerot, Calle Froste, Per Lindwall and Fredrik Brunell for agreeing to the telephone interviews.

Marcia, you have been an incredible support throughout the work of the thesis. Your advice and comments have guided us through the process of creating this thesis. You have taught us so much, and for this we are extremely grateful. Thank you.

Göteborg, June, 2004

Anette Karlsson

Maria-Pia Sjöberg

TABLE OF CONTENTS

TABLE OF CONTENTS	1
APPENDICES	2
APPENDIX I SECTION 201 OF THE SARBANES-OXLEY ACT	2
APPENDIX II QUESTIONNAIRE, BIG FOUR. ENGLISH.....	2
APPENDIX III QUESTIONNAIRE, BIG FOUR. SWEDISH.....	2
APPENDIX IV PRESENTATION OF REPRESENTATIVES OF BIG FOUR.....	2
APPENDIX V QUESTIONNAIRE, TOPIC-RELATED ACTORS, ENGLISH.....	2
APPENDIX VI QUESTIONNAIRE, TOPIC-RELATED ACTORS, SWEDISH	2
1. INTRODUCTION	3
1.1 BACKGROUND	3
1.2 PROBLEM	3
1.3 PURPOSE.....	4
1.4 DELIMITATIONS	4
1.5 DISPOSITION.....	4
2. METHODOLOGY.....	6
2.1 SCIENTIFIC APPROACH.....	6
2.2 RESEARCH APPROACH	6
2.3 QUALITATIVE VS. QUANTITATIVE METHOD.....	7
2.4 PRIMARY DATA.....	7
2.4.1 INTERVIEWS	7
2.5 SECONDARY DATA	9
2.6 RESEARCH EVALUATION	9
2.6.1 VALIDITY.....	9
2.6.2 RELIABILITY	10
2.6.3 RELEVANCE	10
2.6.4 CRITICISM OF THE SOURCES	10
3. THEORY.....	12
3.1 ROLE OF AUDITING.....	12
3.2 AUDITOR INDEPENDENCE	12
3.2.1 DIFFERENT APPROACHES TO INDEPENDENCE	12
3.3 NON-AUDIT SERVICES	13
4. HISTORICAL BACKGROUND	15
4.1 HISTORY OF EXTERNAL AUDITING	15
4.1.1 PRE INDUSTRIAL REVOLUTION:.....	15
4.1.2 DURING THE INDUSTRIAL REVOLUTION:.....	15
4.1.3 1920-1960:	16
4.1.4 1960S UNTIL TODAY:	16
4.2 TWO IMPORTANT SCANDALS.....	17
4.2.1 THE ENRON SCANDAL	17
4.2.2 THE SKANDIA SCANDAL	18
5. REGULATIONS ON AUDITING	20
5.1 THE SARBANES-OXLEY ACT	20

5.1.1 SUMMARY OF THE SARBANES-OXLEY ACT.....	20
5.1.2 SECTION 201	21
5.2 EU PROPOSAL OF A NEW DIRECTIVE REGARDING AUDITS.....	23
5.2.1 AUDITOR INDEPENDENCE	23
5.3 THE ANALYSMODELLEN.....	24
6. EMPIRICAL RESEARCH	26
6.1 INTERVIEWS WITH THE REPRESENTATIVES OF THE BIG FOUR.....	26
6.1.1 EFFECTS ON WAYS OF WORKING	26
6.1.2 EFFECTS ON PROVIDED SERVICES	27
6.1.3 EFFECTS ON INDEPENDENCE	28
6.1.4 EFFECTS ON PROFITABILITY	29
6.1.5 EFFECTS ON COMPETITION	30
6.1.6 EFFECTS OF THE PROPOSED EU REGULATION ON AUDIT	30
6.2 INTERVIEWS WITH TOPIC-RELATED ACTORS	31
6.2.1 EFFECTS ON PROVIDED SERVICES	31
6.2.2 EFFECTS ON INDEPENDENCE	32
6.2.3 EFFECTS ON COMPETITION	32
7. ANALYSIS	33
7.1 EFFECTS ON WAYS OF WORKING	33
7.2 EFFECTS ON PROVIDED SERVICES	33
7.3 EFFECTS ON INDEPENDENCE.....	34
7.4 EFFECTS ON PROFITABILITY	35
7.5 EFFECTS ON COMPETITION.....	36
7.6 EFFECTS OF THE PROPOSED EU DIRECTIVE ON AUDIT	36
8. CONCLUDING DISCUSSION	38
8.1 CONCLUSIONS	38
8.1.1 EFFECTS ON WAYS OF WORKING	38
8.1.2 EFFECTS ON PROVIDED SERVICES	38
8.1.3 EFFECTS ON INDEPENDENCE	38
8.1.4 EFFECTS ON PROFITABILITY	39
8.1.5 EFFECTS ON COMPETITION	39
8.1.6 EFFECTS OF THE PROPOSED EU DIRECTIVE ON AUDIT	39
8.1.7 MAIN PROBLEM	40
8.2 FURTHER RESEARCH.....	40
9. LIST OF REFERENCES.....	41

APPENDICES

APPENDIX I	SECTION 201 OF THE SARBANES-OXLEY ACT
APPENDIX II	QUESTIONNAIRE, BIG FOUR. ENGLISH
APPENDIX III	QUESTIONNAIRE, BIG FOUR. SWEDISH
APPENDIX IV	PRESENTATION OF REPRESENTATIVES OF BIG FOUR
APPENDIX V	QUESTIONNAIRE, TOPIC-RELATED ACTORS, ENGLISH
APPENDIX VI	QUESTIONNAIRE, TOPIC-RELATED ACTORS, SWEDISH

1. INTRODUCTION

This chapter provides a background for the research. The main problem and the purpose of the research are discussed and the six areas that the research will be focused on are introduced. The chapter also presents the delimitations and the disposition of the thesis.

The purpose of this chapter is to provide a foundation for the research and clarify the structure of the thesis.

1.1 BACKGROUND

Accounting scandals have, during recent years, been a frequently discussed topic in the United States. In the aftermath of cases such as Enron and WorldCom, a new law has been passed in the United States to help avoid future scandals and reinforce trust in the audit profession. The law, the Sarbanes-Oxley Act, came into force on July 30, 2002. The Act applies to all companies, American as well as foreign, that have registered stocks or ADR (American Depository Receipts) for trading on the American stock exchanges. The Sarbanes-Oxley Act also applies to companies that have initiated the process of becoming listed according to the above (Svernlöv & B:son Blomberg 2003[a]). One of the issues regulated in the Act, in Section 201, is the prohibition for an auditing firm to provide a client with both audit and non-audit services.¹ Since most auditing firms offer both traditional audit services and non-audit services, this prohibition will have impact on auditing firms as well as the companies using both services. Swedish auditing firms, and especially the so-called Big Four², audit both Swedish companies listed in the USA and subsidiaries of American companies. This means that an American law will have effects on Swedish auditing, an unusual situation that forms the foundation of this research.

1.2 PROBLEM

In order to understand the problem of the thesis it is important to get a picture of the division between audit and non-audit services in Swedish auditing firms. Apart from traditional auditing, most Swedish auditing firms offer services that are not immediately connected to auditing. These non-audit services include investment advisement, bookkeeping and actuarial services. Previously, these services also included management consultancy but in the year 2002 three of the Big Four auditing firms (KPMG, Ernst & Young and PricewaterhouseCoopers) separated the management consulting from the audit part worldwide (Firth 2002). Because of the regulations in the Sarbanes-Oxley Act, Swedish auditing firms are no longer allowed to offer their clients, which are affected by the Act, both audit and those non-audit services that are prohibited under the Act. Examples of such companies are Swedish Match, Volvo, SKF and TeliaSonera, but also subsidiaries of foreign companies that are listed on American exchanges. What this means for Swedish auditing firms is still relatively unknown and therefore the aim of this thesis is to explore this subject further.

¹ See Appendix I for Section 201 of the Sarbanes-Oxley Act

² KPMG, Ernst & Young, Öhrlings PricewaterhouseCoopers and Deloitte, hereafter referred to as the “Big Four”

For this reason the main problem of this research is formulated as follows:

- *What effects will the division of audit and non-audit services in Section 201 of the Sarbanes-Oxley Act have on the activities of Swedish auditing firms?*

In order to find the answer to the main problem, we have focused on six different areas that are relevant in order to decide the effects on Swedish auditing firms. These areas are:

- Ways of Working
- Provided Services
- Independence
- Profitability
- Competition
- As a proposal for a new EU Directive on statutory audit recently has been released, we have also chosen to look at the impact that this proposal may have for auditors in relation to the effects of Section 201 of the Sarbanes-Oxley Act.

1.3 PURPOSE

The purpose of this research is to describe the effects that the division between audit and non-audit services in Section 201 of the Sarbanes-Oxley Act will have on the activities of Swedish auditing firms. This is to be done by analyzing how the auditing market and auditing firms adapt to the new regulations. It is also our aim to increase knowledge of the importance, applicability and the implementation of Section 201 of the Sarbanes-Oxley Act.

1.4 DELIMITATIONS

As stated above, the Sarbanes-Oxley Act only applies to companies that are listed on American exchanges and to subsidiaries of such companies. Most of the companies located in Sweden that are affected by the Act are audited by the Big Four and for this reason we have chosen not to interview representatives of other auditing firms.

When conducting this research, our point of view has always been how the auditors are affected. It is therefore vital to remember that the effects that Section 201 will have on the companies that are affected by the Act lie outside the scope of our research.

1.5 DISPOSITION

The disposition of the thesis is as follows:

In the *Introduction* chapter, the problem of the research is discussed along with the purpose and the delimitations of the research.

In the *Methodology* chapter, the methods that the research is based on are described and the grounds for the chosen methods are stated.

In the *Theory* chapter, audit theory is presented. The role of auditing, the issue of independence and the character of non-audit services are discussed.

In the *Historical Background* chapter, an outline of the background of the research is given. The first part of the chapter gives a brief review of the development of audit in the Western World and specifically in Sweden. The second part presents two recent scandals, one American and one Swedish, that give a picture of what the issues of the scandals have been.

In the *Regulations on Auditing* chapter, relevant Audit regulations are presented. First, there is a brief description of the Sarbanes-Oxley Act in general, followed by an outline of the regulations of Section 201. Second, the proposal for a new EU Directive on statutory audit and the Swedish Analysmodellen are presented.

In the *Empirical Research* chapter, the results of the interviews with representatives of the Big Four are presented. The results are divided into the six sub areas that are distinguished in the problem discussion. Thereafter, we present the results of the four additional interviews with persons, connected to the topic, that have another angle of approach than the representatives of the Big Four.

In the *Analysis* chapter, the results of the empirical research are combined with the theoretical framework presented in chapters three through five and the information is analyzed in order to find what effects Section 201 of the Sarbanes-Oxley Act will have on the activities of Swedish Auditing firms.

In the *Concluding Discussion* chapter, the conclusions that have been drawn from the analysis are presented. The conclusions are going to fulfill the purpose of the research and provide an answer to the research problem. Also, the chapter contains suggestions for further research in the subject.

2. METHODOLOGY

In this chapter, the methodology of the research is outlined. After a brief description of the more general character of the methodology used, the interviews that are conducted during the research are discussed. After that, secondary data is discussed and the chapter is completed by a discussion on the research evaluation.

The purpose of the chapter is to present how the research has been conducted, which is important for the understanding of the following chapters.

2.1 SCIENTIFIC APPROACH

Scientific research can be divided into two main approaches, the positivistic and the hermeneutic. The positivistic approach aims to describe and explain phenomena through logic and quantitative measurements (Eriksson & Wiedersheim-Paul 2001). Knowledge and research is based on tested, systematic experience (Arbnor & Bjerke 1994). The hermeneutic approach, on the other hand, aims to give a holistic view of the problem through analysis and discussion. Supporters of the hermeneutic view feel that scientific methods are not suited for research in the field of social science (Arbnor & Bjerke 1994). The hermeneutic method is based on a spiral where interpretation and dialogue leads to increased understanding and knowledge. This spiral of increased knowledge begins with a certain level of pre-understanding of the subject. Thereafter the researcher gains more information through dialogue with, for example, persons of greater knowledge and/or literature on the subject. This newly gained information is interpreted by the researcher, which gives the researcher more understanding on the subject. Through this, new questions arise that are answered through new dialogues with the research material (Eriksson & Wiedersheim-Paul 2001).

The purpose of the research is to describe the effects that the division between audit and non-audit services in Section 201 of the Sarbanes-Oxley Act will have on the activities of Swedish auditing firms. This purpose implies approaching the problem through discussions and analysis, which means that the hermeneutic approach is the most appropriate. Throughout the research, the hermeneutic spiral has been an important tool in the process of interpreting each piece of new information, especially with the information received from the interviews.

2.2 RESEARCH APPROACH

This research is both descriptive and explanatory. A descriptive approach aims to reproduce and document reality. Eriksson and Wiedersheim-Paul (2001) claim that a good description often is a necessary foundation to explain, understand, predict or decide. In addition to describing the effects of the division between audit and non-audit services on the activities of Swedish auditing firms, the research also aims to explain the reason why things are the way they are and therefore the research also has an explanatory approach.

2.3 QUALITATIVE VS. QUANTITATIVE METHOD

According to Andersen (1998), there are two main methods upon which research can be based: quantitative and qualitative methods. The quantitative method is carried out according to clear guidelines and is characterized by mathematics and statistics. Such methods are formalized and structured (Holme & Solvang 1997). As opposed to the quantitative method, the qualitative method is focused on obtaining deeper understanding. Information is gathered from few sources but the gathered information is more extensive. Qualitative studies are flexible and aim to understand and discern patterns (Trost 1997). For the purpose of this research, the qualitative method is the most suitable, as our aim is to increase knowledge on the effects of Section 201 and therefore a qualitative method that increases understanding is needed.

2.4 PRIMARY DATA

When conducting this research, we have used both primary and secondary data. The main feature of primary data is that it is new information collected by the researcher (Andersen 1998). In our case the primary data consists of interviews with persons that possess great knowledge on the subject.

2.4.1 INTERVIEWS

The research is based on personal, in-depth interviews with persons who work daily with the Sarbanes-Oxley Act and therefore possess great knowledge on the subject. Since the purpose of the interviews is to get a holistic picture of the effects of the division between audit and non-audit services, we found it important to interview representatives of all of the Big Four auditing firms. The Sarbanes-Oxley Act affects relatively few Swedish companies and most of these are audited by one of the Big Four. Furthermore, global companies are often audited by one of the Big Four auditing firms, which means that Swedish subsidiaries of American companies also use this same auditing firm. For this reason we do not find it necessary to interview any of the smaller auditing firms and our opinion is that four main interviews are sufficient for the purpose of the research. The Sarbanes-Oxley Act is still a relatively new issue for Swedish auditing firms and that makes it important to get in contact with the most suitable persons. Therefore, the auditing firms have been asked to recommend the person most knowledgeable about the subject. It is important to remember that the information we have received during the interviews is the opinion of the persons asked, and not the opinion of the represented firms. Some of the interviewees have expressed wishes to be either totally or partly anonymous in the Empirical chapter, which is something that we have respected while writing the Empirical chapter. Therefore, the name of the person who made a certain statement is often not mentioned in the Empirical chapter. Instead the word “interviewee” is used as a way to secure anonymity. The interviews were conducted in Swedish by both authors and all of them lasted approximately an hour.³ Both authors took notes and asked questions. The interviews were translated into English and the Empirical chapter has been sent to the interviewees for approval. This way, any mistakes due to translation are hopefully eliminated. At the same time, the interviewees had a chance to make sure that we kept their

³ See Appendices II & III for interview questions, Big Four

anonymity. Two of the interviews, with KPMG and Deloitte, took place in Stockholm at their Swedish head offices and the other two took place at the Gothenburg offices of Ernst & Young and Öhrlings PricewaterhouseCoopers. The persons that were interviewed were Michael Bernhardt at Deloitte, Helena Herlogsson at Ernst & Young, Olof Herolf at Öhrlings PricewaterhouseCoopers and Peter Åkersten at KPMG.⁴

The advantages of using personal interviews are that they enable the interviewers to ask follow-up questions and thereby receive more information on something important. It is flexible in the way that both interviewers can hear the full answers, take notes and ask questions, as opposed to telephone interviews. It is also convenient when the questions are complicated and easily misunderstood. There are, however, some disadvantages with personal interviews. First of all, it can be difficult to contact persons who are willing to be interviewed. This has been a problem during our research, since not many people are well informed on the Act. Having just a few interviews makes it more difficult to draw general conclusions on the subject, something that is very important to keep in mind. Another risk with personal interviews is that the interviewer may influence the interviewee's answer (Eriksson & Wiedersheim-Paul 2001). In order to avoid that, we have made sure not to ask leading questions. When leading the interviewee in his or her answer, you hint to the interviewee on what the answer could be and through that the person who is being interviewed is likely to settle for the answer that has been hinted at.

In addition to the four main interviews that the research is based on, we have also carried out four telephone interviews.⁵ The purpose of the interviews was to get a picture of the public opinion on the subject. The need for these additional interviews arose as the interviewees of the Big Four indicated that Section 201 of the Sarbanes-Oxley Act has less influence on Swedish auditing firms than has been suggested in media. These interviews only consisted of four questions and only three of our research areas are covered. We did not think it relevant to cover all areas in these interviews as the opinions of persons outside the auditing firms have little relevance to the areas that were not covered. The interviewees were selected because they have knowledge on the subject and they are related to the topic through their work. Calle Froste is a journalist at Affärsvärlden and often writes about audit issues. Per Lindwall is also a journalist, at Dagens Industri, and has written articles about the Sarbanes-Oxley Act. Tord Jonerot is Head of Group Accounting at Handelsbanken. Finally, Fredrik Brunell is Vice President of Investor Relations at Volvo AB. The interviews were carried out by Maria-Pia Sjöberg, who took notes during the interviews.

The main advantage of interviews over the telephone is that they are quick to carry out and therefore, it is easier to get a person to consent to participating in the interview. It also has the same advantage that personal interviews have where it is possible to clarify questions and ask follow-up questions (Eriksson & Wiedersheim-Paul 2001). On the other hand, it is more difficult to understand and interpret a person's statements over the telephone and it is easier for the interviewer to be misunderstood, than when you are face to face with the interviewee. It can also be difficult to ask complicated questions over the telephone and there is always the risk that the person carrying out the interview will affect the interviewee's answers. Since the interviews were short and the responses were documented immediately afterwards, we feel that the disadvantages of telephone interviews have been minimized.

⁴ See Appendix IV for presentation of the representatives of the Big Four

⁵ See Appendices V & VI for the interview questions

Interviews can be structured in three different ways: structured, unstructured and partly structured. In a structured interview the questions are predetermined and this method is often used when one wants to quantify results. An unstructured interview is useful when the interviewer does not have extensive knowledge of the subject. The questions are open and the interview has the form of a conversation. An open question has no direct answer; instead it urges the interviewee to speak freely on the subject. The partly structured interview is the method that has been used during the research. The questions were prepared in advance and asked of all the interviewees. This method is flexible since the personal contact makes it possible to adjust the interview to the situation (Andersen 1998). The method is also suitable in this situation since it enables the interviewers to cover the whole subject without steering the conversation too much.

2.5 SECONDARY DATA

Secondary data is information collected by someone else for another purpose. It is less costly to use than primary data and is often easier to gather (Andersen 1998). For the purpose of our research, secondary data has been assembled from different databases, the Internet and literature. The databases have been used for the search of scholarly articles because it has been our aim throughout the research to use peer-reviewed material where possible. It is, however, not always possible to use scholarly articles. For example, when writing about the Skandia scandal, we have been forced to use material from daily newspapers, because it is such a recent event. The Internet has been used for gathering information on companies and auditing firms but it has also been used to download regulations and other factual material. The literature that we have used has mainly been used for the Theory chapter and for guidance in conducting and documenting research.

One of the disadvantages of secondary data is the risk of information overload and the researcher must be able to see what is relevant. Another disadvantage is that the information seldom is adjusted to the research since the person who collected the data did not have this particular research in mind during his or her research (Andersen 1998).

2.6 RESEARCH EVALUATION

When conducting research, it is of great importance to evaluate and question the sources of the research and the conclusions drawn from it. To do this, validity, reliability, relevance and criticism of the sources are common tools. The issues of validity and reliability are, however, not as easy to apply when conducting qualitative research as they are when conducting quantitative research. Both the validity and the reliability are mainly concerned with how representative the statistical research is (Holme & Solvang 1997). Nevertheless, high validity and reliability of the research improves the quality of the research and therefore must be considered, but from a qualitative point of view.

2.6.1 VALIDITY

According to Dag Smith (2000), validity is achieved if the research reproduces those aspects of reality that it intends to. Validity is impaired when the material from which conclusions are

drawn is incorrect or defective. To improve the validity of this research the following questions need to be answered. Have we interviewed persons of relevance to the problem? Have we asked questions that are relevant? The importance of these issues has been taken into consideration when choosing the interviewees and formulating the questions. The persons whom we have interviewed have great knowledge on the subject, but there is always a risk that the interviewees are subjective. There is also a risk that the interviewers' perception of the situation is wrong or that the interviewers affect the interviewee's answers (Holme & Solvang 1997). During the interviews we have been aware of these problems and attempted to minimize the risk of affecting or misinterpreting the interviewees or their answers.

2.6.2 RELIABILITY

The concept of reliability states to what extent the results are affected by coincidence. It also measures how trustworthy and precise the measurements are (Andersen 1998). According to Eriksson and Wiedersheim-Paul (2001), research is reliable if another researcher would have reached the same results as the first one. It is our belief that if another interviewer asked the interviewees the same questions, they would come to the same results. There is, however, a possibility that the interviewees are tinged with their own, or the auditing firm's, opinions. Another possibility is that we, as interviewers, interpret the answers we get from the interviewees incorrectly (Trost 1997). For this reason all interviewees have been asked to read the draft of the Empirical chapter and approve the information given. As we are aware of the problems associated with the personal interviews, our opinion is that the reliability of the research is improved.

2.6.3 RELEVANCE

Research is relevant when it is of interest and significance to people other than the researchers themselves (Eriksson & Wiedersheim-Paul 2001). The implementation of the Sarbanes-Oxley Act will lead to changes in the work and structure of the auditing firms. For this reason, we believe that a survey of the effects on Swedish auditing firms can be of great relevance for auditors as well as their clients.

2.6.4 CRITICISM OF THE SOURCES

When conducting research, it is of the utmost importance to be critical of the sources that are being used. According to Eriksson and Wiedersheim-Paul (2001) the purpose of criticism of the sources is to investigate whether or not the sources are valid, reliable and relevant. This investigation can be carried out in four steps: observation, origin, interpretation and usefulness (Holme & Solvang 1997).

When observing the available material it is important to decide which sources are relevant. Since the interviews with the representatives of the Big Four are the basis of the research, we have put a lot of effort into finding the most suitable and knowledgeable interviewees. This has also been important when choosing interviewees for the telephone interviews, but since the main purpose of these interviews is to get a picture of public opinion, their expertise on the subject only needs to be of a more general nature. As for the collection of secondary data,

there is always a risk that the information that has been gathered does not represent all aspects of the subject.

The next step of the criticism of the sources is to establish the origin of a source and the impact the origin has on the reliability of the source. When conducting interviews it is vital to remember that the interviewees are affected by different factors that influence their opinions and their answers. The scholarly articles that have been used in the research can be considered to have high reliability because relevant experts always review such articles before being published. However, we have in some cases also used articles from daily newspapers and the reliability of these sources have been taken into consideration when using such sources.

The third step has to do with how the authors interpret the sources. This is an issue that is crucial when conducting research that is based on interviews, as it is easy for the interviewer to misinterpret the interviewee. As the interviews have been conducted in Swedish and translated into English, the risk of misinterpretation is even greater. To avoid this problem, we have, as stated above, let the representatives of the Big Four read the Empirical chapter in draft form. The problem of misinterpretation is also present when reading secondary data. It is, however, easier to avoid the problem of misinterpretation when it is possible to reread the information, as is the case when studying literature.

Finally, the usefulness of a source depends on how useful it is for the purpose of the research. This has been taken under consideration throughout the research, and irrelevant information has been excluded from the research. This evaluation of information has been carried out both during interviews and studies of literature.

In this chapter, the methodology that will be used during the research has been outlined. In the following chapters, theory and history of auditing will be presented along with a brief description of two accounting scandals and a summary of the audit regulations that are relevant to the research. This framework will be used when analyzing the empirical information.

3. THEORY

This chapter will present a theoretical framework from which the research can be interpreted. The chapter presents theory on the role of auditing, auditor independence and non-audit services. This theoretical framework will be used when analyzing the empirical material.

3.1 ROLE OF AUDITING

According to Hayes et al. (1999), the primary function of the audit is to lend credibility to the financial statements prepared by management. Today, ownership and management of a company is often separated, which means that the investors are not involved in the running of the company. Therefore management needs to be able to communicate the financial situation of the company to the investors. Because the financial statements are the main source of information for the investors it is essential that the financial statements reflect reality and can be trusted. Control of the financial information by an impartial, external auditor is therefore in the interest of both the investors and the managers (Porter et al.1996).

3.2 AUDITOR INDEPENDENCE

According to Porter et al. (1996 p.64), independence is considered to be the “cornerstone of auditing”. An audit carried out by an auditor who is lacking in independence is useless to the users of financial statements. For an auditor, it is not enough to have the skills and knowledge on how to carry out an audit. It is also necessary to be independent of the client in order to be able to report on detected errors and demand changes. The main features of independence are therefore that the auditor is impartial, has no personal interests in the client’s company and is not susceptible to pressure or influence (Firth 2002). According to Bahram Soltani (2004), auditor independence is of great importance to the market because it lends credibility to the financial statements. Through this credibility, the financial markets will be more efficient and the cost of capital will decrease because investors’ ability to make rational decisions increases (Soltani 2004). It is important to be aware of the fact that, to some extent, an auditor indeed is dependent on his or her clients because the client is the one paying the audit fee. This means that the auditor may be in the situation of having to criticize the financial statements of the client who, indirectly, is paying his or her salary. On the other hand, risking its independence would be fatal to an auditing firm because auditors are very dependent on their reputation. Therefore, most auditors are always very cautious not to jeopardize independence.

3.2.1 DIFFERENT APPROACHES TO INDEPENDENCE

Independence is often considered to be of a twofold character: independence in fact and independence in appearance. Both are equally important to the quality of the audit. Independence in fact is concerned with auditor objectivity. It stresses the importance of being objective and impartial (Hayes et al. 1999) and being able to evaluate and criticize the financial statements without being affected by personal bias (Porter et al. 1996). Independence in appearance, on the other hand, is a matter of how other people interpret the

independence of the auditor (Hayes et al. 1999). There is a need to create the impression that it does not matter to the auditor what the outcome of the audit is, that is, the auditor will have no problem criticizing the client's financial statements if needed (Bartlett 1991). This means that it is important to the auditor to be aware of which actions might make other people doubt his or her independence and objectivity (Porter et al. 1996).

Mautz and Sharaf (1961), present another approach to the concept of independence. They have identified three phases of independence. The first is independence of approach and attitude, which is characterized by self-reliance, professional judgment and not being affected by client pressure. The second phase is concerned with the independence that is needed to be critical during the audit process. Mautz and Sharaf claim that freedom from bias and prejudice, obvious as well as hidden, is crucial to be able to keep a critical approach. It is important for the auditor to be aware of the risk of being affected by the client's opinion in order to remain independent. The third phase recognizes that it is of vital importance that there is acceptance from the public of the audit opinion. If the audit opinion is not publicly accepted, the function of the audit is lost.

Finally, according to Watts and Zimmermann (1979), auditor independence can also be defined as the probability that the auditor will report a discovered breach in the financial reports. They claim that there are two factors that affect the likelihood of a revelation of such a breach: the probability that the auditor will detect a possible violation and the probability that the auditor would reveal the violation. The first probability has to do with the auditor's skills and how much work she or he puts into the auditing process. The second probability is a matter of how independent the auditor is and his or her ability to withstand any pressure from the client.

3.3 NON-AUDIT SERVICES

When performing an audit, it is of great importance to the auditor to have extensive knowledge of the client's company. This, combined with the professional skills that an auditor must possess, makes the auditor a perfect consultant for the client. Such consultancy services include, for example, legal advice, tax services, management functions and bookkeeping. Such services, not directly related to the audit, are referred to as non-audit services (*The Sarbanes-Oxley Act of 2002*, Section 2). According to Kinney et al. (2004), the provision of non-audit services can lead to a better audit. When carrying out the non-audit services, the auditor will gain more familiarity with, for example, the client's computer and internal controls systems and through that the quality and the accuracy of the audit could be improved.

There are, however, problems related to the provision of non-audit services. Many believe that providing non-audit services to an audit client could impair the quality of the audit (Firth 2002). This is mainly a question of lack of independence towards the audit clients. When providing non-audit services, the auditors often gain a close relationship with management that can cause a situation where the auditors take sides with the client instead of following regulations (Soltani 2004). There is also a risk that the increased income that is due to the provision of both audit and non-audit services could add to the auditing firm's dependence on the client (Firth 2002). When facing the risk of losing both the audit and the non-audit services of a client it is believed that an auditor is less willing to criticize a client's financial statements than if the auditor only provides one of the services (Sharma & Sandhu 2001).

The issue of non-audit services as a threat to independence is not only a result of the recent accounting scandals. Since consultancy became a part of the profession, there has been a fear that it will impair independence. For example, in 1981, the American Institute of Certified Public Accountants (the AICPA)⁶ limited the types of non-audit services that an American auditor is allowed to perform for an audit client. Examples of such services are executive recruitment and public opinion polls (Pany & Reckers 1984). Also, in 2000, A. Levitt, who was then chairman of the Securities Exchange Commission (the SEC)⁷, uttered the concern that “[t]he audit function is simply being used as a springboard to more lucrative consulting services” (Kinney et al. 2004, p.562).

This chapter has discussed the audit function in the theoretical context. The next chapter will instead provide the reader with a description of the audit reality. The chapter contains a brief summary of the history of audit and, the emergence of the Big Four. This summary is followed by a presentation of two accounting scandals relevant to the purpose of the research.

⁶ The AICPA is a non-governmental organization of accountants that issues Statements of Auditing Standards (SAS)

⁷ The SEC is an independent government body that makes regulations for companies that are listed on American stock exchanges

4. HISTORICAL BACKGROUND

This chapter will give an outline of the history of external auditing in the Western world with extra focus on Sweden. This outline will give a picture of the emergence of the Big Four and the evolution of the audit profession. The chapter also presents two accounting scandals that are relevant to the research.

The purpose of this chapter is to provide a platform of understanding from which the research can be understood. To have some insight into the scandals will make it easier to understand the purpose of the Sarbanes-Oxley Act and its effects.

4.1 HISTORY OF EXTERNAL AUDITING

4.1.1 PRE INDUSTRIAL REVOLUTION:

Prior to the Industrial Revolution, the financial market consisted of small companies that were owned and managed by the same persons. Because of this situation, there was no reason for the owners to disbelieve the management of the companies and therefore no need for an audit. However, when trading overseas, investors demanded that the ship captains accounted for the trade they carried out. Therefore there was a need for an audit of the accounts so that the investors could trust the information given. The main purpose of the audit was to detect fraud (Porter et al. 1996).

4.1.2 DURING THE INDUSTRIAL REVOLUTION:

The Industrial Revolution that started in Great Britain resulted in the emergence of large industrial and commercial companies and investments and management was separated. In order to finance the expansion, there was a great need for external capital. Therefore, there was a need for audits of financial information in order to protect the investors who no longer were involved in the management of the companies (Hayes et al. 1999). The need for audit also increased with the growing middle class, which invested small amounts but were many in numbers. This meant that the companies had a large number of owners. This situation, combined with a badly regulated stock market, resulted in the need for protection of investors. Apart from detection of fraud the audit was also expected to vouch for the truthfulness of the company's balance sheet (Porter et al. 1996).

In Sweden the Industrial Revolution lagged behind other industrialized countries. Around the middle of the 19th century the population still consisted mostly of farmers, and only 10 per cent of the population earned their living by trade. By the beginning of the 20th century, the numbers of limited companies started to grow and by this time there were about 500 companies founded a year, a figure that was doubled sixteen years later (Wallerstedt 2001). In the year 1895, in the Swedish Companies Act, it was first settled that all limited companies should have at least one auditor. It was, however, not until 1912 that the Stockholm Chamber of Commerce authorized the first six Swedish auditors. Even at this point it was emphasized

that an auditor must be independent. Due to the fact that the requirements for authorization as an auditor were demanding, very few obtained the title, though, and there was a great shortage of auditors (Wallerstedt 2001).

4.1.3 1920-1960:

During this period there was continued growth in numbers of modern corporations and, with this, investment. This growth called for development of the stock markets and credit-providing institutions such as banks. The investors had no personal connection to the companies and therefore investors could easily move their capital to another company. The main purpose of investments was to get high returns and therefore the audit was expected to attest to effective and efficient use of funds (Porter et al. 1996). Moreover, detection of fraud was no longer the most important part of the audit but instead the main task was to provide the financial statements with credibility. It was during this period of time that an audit no longer involved controls of all transactions; instead control of the internal control procedures and random sampling was used. The sampling techniques that were developed also resulted in that the auditors had great knowledge of the companies they audited. This made it possible for them to assist the companies with consultancy services that were not closely related to the audit.

This period was very prosperous for Swedish companies. Around the middle of the century almost 75 per cent of the population made their living in service and trade. In March 1932, the Kreuger financial scandal was discovered. The scandal shocked the financial world and especially the Swedish auditing profession. The auditors' mistake was lack of independence towards Kreuger and thereby the Swedish auditors' reputation was damaged. The Swedish government asked the auditing firm Price Waterhouse to assist in the investigation of the scandal, and thereby Price Waterhouse entered the Swedish auditing market (Wallerstedt 2001).

4.1.4 1960S UNTIL TODAY:

The last fifty years have seen the development of global corporations and multinationals (Porter et al. 1996). Following this development was the evolution of large auditing firms that held a large part of the auditing market share. In 1975, there were eight big auditing firms in the United States, known as the 'Big Eight'. The Big Eight consisted of Arthur Andersen & Co., Price Waterhouse & Co., Coopers & Lybrand, Peat Marwick International (PMI), Ernst & Ernst, Arthur Young & Company, Deloitte, Haskins & Sells and Touche Ross & Co (Zeff 2003). Hand in hand with the growing competition, consultancy became more and more common within the auditing firms. This development was accelerated by the fact that the auditing market was saturated and the competition among the firms drove down audit fees. By the year 1983, Arthur Andersen was one of the top consultancy firms in the USA (Zeff 2003). Due to the fact that the margins from consultancy in some cases were higher than the margins from auditing, the Big Eight's reliance on auditing decreased a great deal during this period (Zeff 2003). At the same time, the criticism of the auditor's independence was growing stronger. In their annual report of 1985-1986, the Public Oversight Board (POB)⁸ warned that the independence was at risk (Zeff 2003). During the 1980s firms started to join together in

⁸ The POB is a US governmental body that is now known as PCAOB. See chapter 5 for description of PCAOB

mergers. In 1987, PMI merged with KMG and formed KPMG (www.kpmg.com). After that, Ernst & Young was founded when Ernst & Whinney⁹ and Arthur Young merged in 1989 (www.ey.com, [b]). That same year, Deloitte & Touche was formed when Deloitte Haskins & Sells merged with Touche Ross & Co. (www.deloitte.com, [b]). Nine years later, Price Waterhouse and Coopers & Lybrand merged their companies and PricewaterhouseCoopers was created. This created the Big Five that later, after the Enron scandal, were narrowed down to the Big Four of today, as Andersen disappeared from the market.

It was not until the year 1983 that Sweden finally had enough authorized or approved auditors to match the demand. In accordance with this, the legislation was changed so that every limited company needed to have either an approved or an authorized auditor. The period from the 1970s to the 1990s was filled with mergers between Swedish auditing firms. The first wave of mergers was driven by the intention of the auditing firms to spread out in the country. The easiest way to do this was to buy already existing firms. The second wave was a reaction to the demands that the international firms had on local partners. The auditing firms needed to have a certain size to be able to offer all the services that a large international company could possibly demand. As mentioned above, Price Waterhouse came to Sweden in 1932. In 1999 the company merged with Öhrlings Coopers & Lybrand and took the name it has today Öhrlings PricewaterhouseCoopers (www.pwc.com). Ernst & Young Sweden has a more complicated history involving several mergers, but it was in the year 1990 that the Swedish firm adopted the name of its international partner (www.ey.com, [a]). That same year, KPMG Sweden also made the decision to take the international partner's name. KPMG has a history of growing organically rather than through big mergers (Wallerstedt 2001). In comparison to the other three Big Four auditing firms, the predecessors of Deloitte & Touche were slow starters and it was not until 1984 that they were established in Sweden. Ten years later the company changed its name to Deloitte& Touche. In 2002, after the Enron scandal, Andersen Sweden was incorporated into Deloitte & Touche (www.deloitte.com, [a]). Today Deloitte & Touche Sweden market themselves as Deloitte, and this is the name that will be used throughout the thesis.

4.2 TWO IMPORTANT SCANDALS

4.2.1 THE ENRON SCANDAL

The Enron scandal is used as an example of the accounting scandals that were the reasons for the creation of the Sarbanes-Oxley Act .

Enron was created as a natural gas company through a merger between two companies, Houston Natural Gas and InterNorth in 1985 (Reinstein & Weirich 2002). The company expanded quickly and was soon one of the largest traders of gas in the world. Before long, Enron became notorious for being a tough employer, known for its merit-based bonus system and strict ranking system. The employees were rated on a scale from 1-5, where five meant that your job was at great risk. This ranking system motivated the employees to make 'good deals'. In fact it motivated the employees to make any deal that had a positive Net Present Value. The employees' urge to get a good ranking is believed to have caused paranoia and this, in turn, made some of the employees close deals in secrecy (Thomas 2002).

⁹ In 1979, Ernst & Ernst joined forces with Whinney, Smith & Whinney

At Enron, Special Purpose Entities (SPE) were used. SPEs are companies that do not have to be consolidated in the financial statement because another investor has invested at least three per cent of the capital and this investor has control of the entity (Reinstein & Weirich 2002). The SPEs can borrow large sums of money and can then buy assets without the parent company having to report the debts. Enron used this method, under the guidance of the Chief Financial Officer (CFO), in order to dispose of intangible assets that were decreasing in value. When Enron was in need of more capital, it used SPEs to borrow funds from outside lenders using its own stock as guarantees. The SPEs therefore owned stocks in Enron, which meant that an increase in Enron stock value would increase the SPEs' profits. Hence, Enron would include profits created by an increase in its stock value in its financial statements. This, in turn, would raise the perceived value of Enron and therefore increase the stock value causing higher profits in the SPEs and so on. Through this, Enron made money out of its own stocks. On the other hand, if Enron stocks would decrease in value, the effect would be the opposite. Many times, executives at Enron had personal interests in the SPEs and therefore made a lot of money from them (Reinstein & Weirich 2002).

In August 2000 the Enron stock was as high as \$90.56/share and Enron was admired all over the world. But when energy prices fell and the whole world economy deteriorated in 2001, Enron felt the pressure from its competitors. In 2001 several analysts started to question Enron and a number of incidents made them believe that their suspicion was right. The Chief Executive Officer (CEO), resigned and handed the post over to the new CEO who himself resigned only six months after being hired. Enron locked investments for 30 days, which meant that the employees were prevented from selling their stock. On November 30, 2001, the stock fell to 26 cents/share and two days later Enron filed for bankruptcy protection (Thomas 2002).

Arthur Andersen LLP was assigned as Enron's auditing firm and has afterwards been accused of not preventing the company's fraud. According to William C. Thomas (2002), many of the employees at Enron, such as CFOs, internal accountants and controllers, used to work for Andersen. Moreover, Andersen was paid millions of dollars both in auditing and consulting fees (Reinstein & Weirich 2002). These two facts suggest that Andersen did not succeed in being independent towards its client. Additionally, Andersen has admitted to destroying thousands of documents concerning Enron. Even Enron's merit-based bonus system and strict ranking system should, according to Thomas (2002), have been warning signs to the auditors that a scandal could occur. These are namely occurrences that should be avoided in order to steer clear of frauds, something that the American Institute of Certified Public Accountants (AICPA) has regulated in SAS No. 82. Yet another mistake that the auditors made was that they did not, as regulated, immediately report suspicions of fraud to the SEC. For example, there is proof that people at Andersen had seen an internal memo from a vice-president where she expressed her fear that Enron might "implode under a series of accounting scandals" (Thomas 2002, p.5).

4.2.2 THE SKANDIA SCANDAL

Skandia was formed in the year 1855 and was originally a traditional insurance company. Today Skandia also acts as fund manager and product developer and works with marketing and market support for its distributors. The company is represented in about 20 countries

(www.skandia.com). The Skandia Scandal is of interest for the research since it is an example of a Swedish scandal that has affected the Swedish public opinion.

In the year 2003 Sweden was struck by what has been called the biggest scandal since the Kreuger crash. The whole year was filled with discoveries of how the management of both Skandia and its subsidiary, Skandia Liv, apparently had taken advantage of their positions through bonuses and illegal renovations of apartments. In April 2003, the CEO of Skandia was dismissed because of several mistakes. One of the main complaints was that he had taken away the ceiling on the bonus-programmes without getting the board of directors' approval. It was also during this time that it was discovered that the management of both Skandia and Skandia Liv, had taken corporate apartments for themselves and renovated these for millions of Swedish crowns and left the bill for Skandia. It was further discovered that there had been several deals between Skandia and Skandia Liv that had been in Skandia's favor but at the expense of Skandia Livs' savers (Beck-Friis 2003). It appeared to some that the auditors had made some mistakes in the Skandia scandal as well. Göran Tidström, CEO of Öhrlings PricewaterhouseCoopers, was appointed to investigate the internal affairs, the auditing methods and the management's bonuses. There were comments on the fact that Skandia's former auditor, Ulf Spång, had been appointed a leading position at Skandia several years earlier. After Spång was hired, Skandia did not change auditing firms. This led to that Ulf Spång had a close relationship with the new auditors, as he in fact was the lead auditor's former boss. However, at the time when Ulf Spång was Skandia's auditor, situations like this were not considered to cause any problems; instead it was rather common for auditors to be offered a position at the company they audited. However, one clear mistake that the auditors made was, according to Göran Tidström, that they did not report to the board of directors that the CEO had removed the ceiling on the bonus-programme. There were also figures missing concerning Skandia's options programme, something that the auditors pointed out to Ulf Spång. He, however, apparently chose to ignore the missing figures, something that the auditors should not have accepted but instead should have reported to the board of directors. These two occurrences should have been reasons for the auditors to disapprove or withdraw from Skandia's audit (Sunden 2003).

This chapter explains the background of audit and the emergence of the Big Four. Also, the Enron scandal is described in order to give the reader an idea of why the Act was created. The Skandia scandal presents a Swedish perspective on accounting scandals.

In the next chapter, regulations on auditing that are of relevance to the research are presented.

5. REGULATIONS ON AUDITING

This chapter outlines the relevant regulations that affect, or may come to affect Swedish auditing firms. Firstly, the Sarbanes-Oxley Act is described and secondly, a résumé of the proposal for a new EU directive on statutory audit is presented. The chapter ends with a description of the Swedish Analysmodellen.

An understanding of these regulations is necessary for the comprehension of the subsequent chapters as both the empirical research and the analysis is based on the regulations presented.

5.1 THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act of 2002 was enacted in the United States as a reaction to various accounting scandals such as Enron and WorldCom and is regarded as the most important change in securities legislation in the United States since the Securities Exchange Act of 1934 (Coustan et al. 2004). The law was written by Senator Paul Sarbanes and Congressman Michael Oxley and was signed into law by the President on July 30, 2002. The Act consists mainly of amendments to the Securities Exchange Act of 1934 and is considered to be a framework within which the SEC, the US securities regulator, is expected to issue further regulations to clarify the rules (Svernlöv & B:son Blomberg 2003[a]). The purpose of the law is to improve confidence in the securities market by making sure that the information companies provide is correct (Svernlöv & B:son Blomberg 2003[b]). This is accomplished by, for example, regulating auditor independence and improving the control of the clients' internal controls. Also, the consequences of not obeying the law are stricter than before.

The law applies to all companies that have registered stocks or American Depository Receipts for trading on American exchanges or market places or that have initiated the procedure of offering securities to a wider circle in the United States (Svernlöv & B:son Blomberg 2003[a]). This means that foreign companies that match this description also must follow the rules of the Act. The law also applies to subsidiaries and affiliates of such companies, which means that, for example, a Swedish subsidiary of an American company must comply with the law (Blix et al. 2002).

5.1.1 SUMMARY OF THE SARBANES-OXLEY ACT

This section provides a summary of the most important parts of the Act, which illustrates the extent of the regulations. The full-text version of the Sarbanes-Oxley Act is available at <http://www.sarbanes-oxley.com/>.

SECTIONS 101-109: PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB)

In Section 101 of the Sarbanes-Oxley Act the creation of a non-governmental board called the Public Company Accounting Oversight Board (PCAOB) is prescribed. All auditors, American as well as foreign, who audit companies that are affected by the law, must be registered with the Board. Among the tasks of the PCAOB are also to establish auditing standards, carry out

inspections of registered public accounting firms and impose sanctions on firms that do not follow the rules of the Sarbanes-Oxley Act.

SECTIONS 201-209: AUDITOR INDEPENDENCE

Sections 201-209 deal with the enforcement of auditor independence. According to the Act, a registered public accounting firm is prohibited from providing an issuer of securities with both audit and non-audit services at the same time. The Sarbanes-Oxley Act also states that an auditor is not allowed to be lead-auditor for an affected client for more than five consecutive years. After the five years the lead auditor must be changed for the affected client, but not the auditing firm itself.

SECTIONS 301-308: CORPORATE RESPONSIBILITY

This part of the Sarbanes-Oxley Act increases the responsibilities of various parts of company management. For example, the rules related to the audit committees of companies have become stricter. The audit committee is in charge of appointing and supervising the auditors and must consist of members of the board of directors. Moreover, the CEO and the CFO are required to sign each quarterly and annual report and thereby certify that the reports are correct and give a true and fair view. The Act also requires the attorney of an affected client to report any violation of securities laws to the Chief Executive Officer or to the Chief Legal Counsel and, if there is no proper response, also to the audit committee or the board of directors.

SECTIONS 401-409: ENHANCED FINANCIAL DISCLOSURES

Additionally, the Sarbanes-Oxley Act contains requirements for more detailed financial disclosures. For example, off-balance sheet transactions and obligations must be disclosed in each quarterly and annual financial report. It is also stated that personal loans to executives are prohibited. One of the most important parts of these Sections deals with increased control requirements of the internal controls. For example, management must, in the annual report, assess the effectiveness of the internal control structure. In addition to this, the auditor of the affected client must, in the audit report, affirm the assessment made by the management.

5.1.2 SECTION 201

Section 201 is the section of the Sarbanes-Oxley Act that the research is based upon. This part of the thesis provides a thorough description of Section 201.¹⁰

Section 201 of the Sarbanes-Oxley Act deals with the regulations on the provision of non-audit services. In the Act, the term ‘non-audit services’ is defined as: any professional services provided to an issuer by a registered public accounting firm, other than those provided to an issuer in connection with an audit or a review of the financial statements of an issuer. Examples of such services are actuarial services, bookkeeping and legal services. In Section 201 it is stated that it is unlawful for an auditing firm to provide both audit services and prohibited non-audit services to an affected client simultaneously. The non-audit services prohibited in the Act are listed below. Auditing firms are allowed to offer audit clients non-audit services that are not listed below, but only if the audit committee approves the activity in advance. The Act does not, in any way, prohibit the provision of non-audit services to a non-audit client (*Sarbanes-Oxley: A Closer Look* 2003). According to the Sarbanes-Oxley Act,

¹⁰ See Appendix I for Section 201 of the Sarbanes-Oxley Act

provision of tax services is not considered to impair independence. Therefore, auditing firms are allowed to carry out tax services for their audit clients as long as the services are pre-approved by the audit committee (*Sarbanes-Oxley: A Closer Look* 2003). In accordance with the regulations of the Sarbanes-Oxley Act, the SEC has issued final rules regarding auditor independence. According to Bahram Soltani (2004), these rules are based on three principles that are considered to be determinants for the independence of the audit profession:

1. An auditor cannot function in the role of management.
2. An auditor cannot audit his or her own work.
3. An auditor cannot serve in an advocacy role for his or her client.

The prohibited non-audit services of the Sarbanes-Oxley Act (Section 201) are listed below. The underlined sentences are direct quotes of the legislation of Section 201.

- (1) Bookkeeping or other services related to the accounting records or financial statements of the audit client. The prohibition on providing bookkeeping services includes traditional bookkeeping and payroll services. An auditor is not allowed to assist the audit client when preparing the financial statement because it is considered to impair the auditor's independence. The auditor is, however, allowed to advise the client on, for example, how to make correct conversions of the financial statements of foreign subsidiaries (*Sarbanes-Oxley: A Closer Look* 2003).
- (2) Financial information systems design and implementation. The service of designing and implementing a client's information system is prohibited if the data will be a part of the financial statement or generate information that is important to the financial statement.
- (3) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports. These prohibited services include valuing assets, liabilities and real estate. Services for non-financial reporting are not prohibited.
- (4) Actuarial services. An actuary works with calculating, for example, life expectancy for the purpose of predicting the expected size of pension funds. Earlier, the prohibition only prevented an auditor from carrying out such services for insurance companies but, with the new regulations, all actuarial services are prohibited.
- (5) Internal audit outsourcing services. Most internal audit services are prohibited, but the auditor is allowed to make recommendations about improvements during the audit process.
- (6) Management functions or human resources. An auditor is not allowed to work as an employee, officer or director at a client's company. Nor is it permitted for the auditor to be involved in recruiting management or employees or negotiating for the client.
- (7) Broker or dealer, investment adviser, or investment banking services. It is unlawful for an auditor to give recommendations on whether to buy or sell a client's securities. Furthermore, the auditing firm is not allowed to make investment decisions on behalf of an audit client or in any other way be in control of the client's investments.
- (8) Legal services and expert services unrelated to the audit. The auditor is prohibited from representing the company in legal matters because this would make the auditor an advocate for the company. The auditing firm is also not allowed to provide an audit client with expert advice to support the company in adversarial proceedings.
- (9) Any other service that the Board (PCAOB) determines, by regulation, is impermissible.

5.2 EU PROPOSAL OF A NEW DIRECTIVE REGARDING AUDITS

On March 16, 2004, the European Commission issued a proposal for a new Directive on the statutory audit of annual accounts and consolidated accounts (www.far.se, [a]). The proposal will be presented to the European Parliament and the Council for approval, which means that it is not yet passed as a law. If passed, all Swedish companies must follow the rules of the new Directive. The Directive is an outcome of recent accounting scandals, such as Parmalat and Ahold, in the European Union but is also considered to be a reaction to the regulations of the Sarbanes-Oxley Act. Many of the regulations in the proposal are similar to the rules of the Sarbanes-Oxley Act. However, the rules of the proposal mainly deal with issues concerning auditors and auditing and do not, in opposite to the Sarbanes-Oxley Act, regulate the actions of, for example, the management of the companies. The purpose of the proposed regulations is to ensure that the users of the financial statements can trust the information given. Among other things, the Directive aims to clarify what an auditor's tasks are and to strengthen the objectivity and independence of the auditor (www.far.se, [b]).

In the Directive (www.far.se, [a]) it is stated:

- That all auditors and auditing firms shall be registered in a national public register. Also, auditors and auditing firms from countries outside the European Union must, under certain circumstances, be registered in the Register of the Member Country where the auditor or auditing firm is active. These rules are similar to the regulations of the Sarbanes-Oxley Act that concerns registrations with the PCAOB.
- That there is a need for public oversight of the audit profession. The oversight must be carried out by non-practitioners that are competent on the subject. This supervision is to be carried out on a national level and can be compared to the supervision that is carried out by the PCAOB in accordance with the Sarbanes-Oxley Act.
- That audit fees must not be affected by the occurrence or the extent of non-audit services provided to the client.
- That when auditors audit companies that are of public interest, there are additional regulations that must be followed. The criteria for being considered to be of public interest are that the company has issued securities, has a large number of employees or because of the nature of the business (for example, banks or insurance companies). Among other requirements, the auditor must provide a description of the Internal Quality Control System and make a governance statement. The proposed Directive also requires all companies of public interest to establish an audit committee that, among other things, is to safeguard the auditor independence and propose an auditor for appointment by the shareholders at the general annual meeting.

5.2.1 AUDITOR INDEPENDENCE

In the proposal for the new Directive, the importance of the auditor's independence of its client is stressed. It states that an auditor must refuse to carry out non-audit services that threaten his or her independence, but there are no services that are prohibited in general. The auditor is, however, required to record all relevant threats to independence, and take suitable actions to avoid the threat. The Directive also prohibits an auditor or an auditing firm from carrying out an audit for a company with which there is a financial, business or employment relationship. One of the greatest differences between the Sarbanes-Oxley Act and the proposed EU Directive is the level of regulations regarding non-audit services. In the

Sarbanes-Oxley Act, the prohibited services are clearly stated while the EU Directive instead lets the auditor or the auditing firms decide whether or not their independence is threatened when providing a certain service.

5.3 THE ANALYSMODELLEN

The Analysmodellen (www.far.se, [c]) is part of a new Swedish legislation on auditing (Revisorslagen) that came into force on January 1, 2002. Like the Sarbanes-Oxley Act, the Analysmodellen is a reaction to the current debates on auditors' independence. The Analysmodellen is focused on the creation of independence and objectivity of the auditors, by questioning each situation to see if there is any reason why the auditor should not perform the audit. In other words, the Analysmodellen, like the EU regulation, does not list the services that are considered to impair independence. Most questions have been left for the auditor to examine by using experience and common sense. In practice, this means that the auditor at all times must evaluate if there is anything that can affect him or her in the audit. The Analysmodellen has focused on keeping the auditor's independence and has therefore listed some situations that can impair independence and affect the audit in a negative way.

- If the auditor has direct or indirect economic interest in the client's activities ("Egenintressehot")
- If the auditor already, in another context, has made up his or her mind in a matter that is enclosed in the audit ("Självgranskningshot")
- If the auditor is, or has been, a support for or against the client's position in a legal or economic matter ("Partsställningshot")
- If the auditor has a close relationship with the client or someone in the client's management ("Vänskapshot")
- If the auditor is subject to a threat or other pressures that aims to cause discomfort ("Skrämselhot")

In these situations, the auditor must turn down the offer to audit the client. It is also up to the auditor to consider if there are any other situations, not listed above, that can affect the independence or the objectivity. There are, however, cases where the auditor can keep the client despite the appearance of one of the listed situations. The first case is if there is no actual reason to question the auditor's independence or objectivity on that special task. An example of this is that business transactions between the auditor and the client do not necessarily impair independence if they are of ordinary character. The other case is if the auditor has taken, or is planning to take, measures that prevents that a lack of independence occurs. When applying the Analysmodellen, the auditor should document the reflections he or she has on the audit. It is important to list all occurrences of threats to independence and document what has been done to avoid them. The documentation is to be used if it is questioned why the auditor has accepted the audit.

In this chapter, we have summarized the actual and proposed legislation important to the understanding of the research. These regulations will be referred to in the subsequent chapters.

In the following chapter the results of the interviews regarding Section 201 of the Sarbanes-Oxley Act are presented.

6. EMPIRICAL RESEARCH

In this chapter, the results of the empirical research are presented. The information is structured into the six areas that were identified in the Problem discussion. If nothing else is stated, the information refers to Section 201 of the Sarbanes-Oxley Act and to the Swedish situation. The opinions stated are the interviewees/respondents own and should not be considered to be the opinion of their employer.

6.1 INTERVIEWS WITH THE REPRESENTATIVES OF THE BIG FOUR

In this section, the results of the main interviews are presented. The areas that are covered are Ways of Working, Provided Services, Independence, Profitability, Competition and the Proposed EU Directive.¹¹ As some of the interviewees preferred to be anonymous, we have respected this by only referring to their names when we had their approval. The interviews were conducted with Michael Bernhardt, Deloitte, Helena Herlogsson, Ernst & Young, Olof Herolf, Öhrlings PricewaterhouseCoopers and Peter Åkersten, KPMG.¹²

6.1.1 EFFECTS ON WAYS OF WORKING

In order to understand how the law has affected the employees at the four auditing firms, the interviewees explain the structure of their way of working. The employees of the Big Four work in teams, both when they audit a client and when they work as consultants. The teams, however, are separated between audit teams and non-audit services teams. The audit teams can sometimes consist of other experts such as taxation experts or IT-experts but this is only to assist in the auditing process. Since the teams were not mixed before the Sarbanes-Oxley Act came into force, the Act does not affect the teams' structure. One of the interviewees explains how the international cooperation within the auditing firms work. When an auditing firm is assigned to be the auditor of a company, that auditing firm is often responsible for the audit all over the world. A lead auditor is assigned and this person coordinates the audit worldwide. If, for example, a Swedish auditing firm is asked by a Swedish subsidiary of an American company to perform an auditing service of any kind, the Swedish auditor will contact the American lead auditor for approval. It is also this lead auditor who handles the contact with the audit committee, which approves the provision of non-audit services that are not prohibited.

The Big Four auditing firms have prepared their employees for the implementation of the Sarbanes-Oxley Act in similar ways. The firms have received information from their American colleagues who possess greater knowledge of the Act, as it is an American law. All auditing firms have had in-service training for the employees involved with the Sarbanes-Oxley Act. Another way to spread information about the Act is through the intranet of the firms. At KPMG the training results in a certificate that proves that the employees are authorized to work with the Sarbanes-Oxley Act. It is of importance to all firms that all employees are aware of the rules of the law and especially the rules that regulate auditor

¹¹ See Appendices II & III for questionnaires

¹² See Appendix IV for a presentation of the interviewees

independence. The reason is that even the auditors who are not working with the law should be aware of what to do if they come in contact with a company that falls under the Sarbanes-Oxley Act.

All interviewees emphasize that the demand for division between audit and non-audit services is not the most prioritized part of the Sarbanes-Oxley Act. Other parts of the Act, such as Section 404 on internal controls, are more labor intensive and therefore have greater effects on both the companies and the auditing firms. The rules of Section 201 are clear and the adaptation to these rules is easily carried out. According to the interviewees, the companies generally just hire another one of the Big Four auditing firms for the prohibited non-audit services. Section 404, on the other hand, requires changes in computer systems and methods of working, which are more complicated and costly. The impact of Section 201 on the Swedish market is, in the opinion of one of the interviewees, further decreased by the existence of the Swedish *Analysmodellen*.¹³ Because of the rules of the *Analysmodellen*, Swedish auditors were, in many cases, not able to provide the now prohibited non-audit services, even before the Sarbanes-Oxley Act.

6.1.2 EFFECTS ON PROVIDED SERVICES

The interviewees have different opinions on whether the division between the audit and non-audit services is an opportunity or a threat to the auditing firms. Two of the interviewees think that the division is just something that the auditing firm has to accept as a fact and that it has both good sides and bad sides. The good side could be, according to one of the interviewees, that the implementation of parts of the Sarbanes-Oxley Act will create more work for the auditing firms; this possibility for more work, however, applies mainly to Section 404 on internal control. Olof Herolf, auditor, says that the law implies that there are many services that now will be prohibited. One of the biggest changes for the auditing firm is that it makes it more difficult to work with an audit client's taxation. Tax services are not one of the non-audit services prohibited in the Sarbanes-Oxley Act, but if the company has a legal dispute, involving taxation, the auditing firm will not be able to assist the company, since legal assistance is one of the prohibited services. For this reason, it is more convenient for the company to turn to another auditing firm for tax services. Herolf concludes that there are fewer services that the auditing firm can offer one and the same client. On the other hand, all firms are in the same situation, which suggests that there are many companies in need of another auditing firm's help with the non-audit services. Two of the interviewees sense a change in the clients' critical view of the auditors and what services the auditors are allowed to offer. This critical view is important, as it is the companies that make the decision on what auditing firm they want to hire. This awareness among the clients is shown by the fact that clients ask more questions and that some of the clients, not even affected by the law, choose to employ different auditing firms for audit and non-audit services.

Regarding the development of the industry and the expectations for the importance of non-audit services in the future, there are some differences among the interviewees. Helena Herlogsson, auditor, predicts that non-audit services will increase in importance in the future and Michael Bernhardt, consultant, points out that more regulations are likely to increase the need for non-audit services. He ascribes this increased need for non-audit services to the fact that the companies will need assistance in adjusting to new laws such as the proposed EU

¹³ See chapter 5 for a description of the *Analysmodellen*

Directive.¹⁴ One of the other interviewees is not of the same opinion but instead predicts that the market will remain the same.

The profit is a very important factor when choosing which of the two services to offer, but there are other factors as well. Two of the factors to look at are what services will be needed for an assignment and what capacity the firm has available at the time. It is, according to three of the interviewees, vital to think strategically and predict the services that will pay off in the future. The fourth interviewee is more concerned with the auditing firm's reputation and is afraid that it will be endangered if the firm takes on too many consultancy jobs. Additionally, the interviewee says that it is essential to remember that auditing is the firm's main task. Finally, one interviewee also emphasizes that the firms are anxious to audit the largest and most important companies, because this is strategically important.

According to Helena Herlogsson, it is important to remember that in the end, it is up to the companies to choose what services they prefer from their auditing firm. The companies must decide if they want to keep their current auditing firm for audit or if they want to use the firm for non-audit services. All the interviewees say that in most cases the clients prefer to keep the present auditing firm for the audit and appoint another firm for the non-related services. One of the interviewees believes that it is not very likely that this will change in the near future. According to another interviewee there are, however, some cases when the client wants to keep the auditing firm for the non-audit services. An example of this situation is if the auditing firm is working on a large non-audit assignment that has involved much effort and time. Olof Herolf has only experienced one case where the client kept Öhrlings PricewaterhouseCoopers for tax services and gave the audit to another auditing firm. The reason in this case was that the client feared ending up in a legal dispute and therefore the auditing firm's expertise in tax matters was most important. In case of a legal dispute regarding the tax work, the auditing firm would not be allowed to assist the company if the firm still was appointed auditor, as expert services are one of the prohibited services.

6.1.3 EFFECTS ON INDEPENDENCE

When asking if auditor independence will increase with the prohibited services of Section 201, only one of the interviewees is of that opinion. This interviewee bases this opinion on the fact that with specific rules, it is no longer up to the auditor to make the judgment of which services impair independence and therefore there will be no doubt. Olof Herolf does not believe that the division between audit and non-audit services is going to affect the auditors' independence. He claims that the worries about independence are exaggerated and that it helps little to implement rules and regulations. Herolf would rather that the evaluations of the auditors' competence and judgment were more extensive, although he admits that this can be complicated to actually realize. One of the other interviewees does not believe that the independence is threatened in Sweden since the Swedish Analysmodellen already requires the auditor to evaluate if the provision of a non-audit service will impair independence. Nevertheless, the division of the audit and non-audit services may increase the confidence of the public, the interviewee continues.

Another interviewee points to the fact that the requirements for division of audit and non-audit services may be a problem for small companies since they often depend on their

¹⁴ See chapter 5 for a description of the proposed EU Directive on statutory audit

auditor's knowledge in many of the issues that are not directly related to the audit. The interviewee in question does not, however, believe that it is the small companies that are at risk when discussing auditor independence. Instead there is more concern with the large companies and therefore it is important to be cautious, so that independence is not threatened when auditing large companies. One of the other interviewees is also of the opinion that the division will not increase independence but is concerned about what the public thinks. If the public believes that division increases independence, then the Act has served a purpose, the interviewee continues. One interviewee fears that the companies regard all non-audit services as prohibited, even though this is not true. The interviewee believes that it is of importance that the client knows that the auditing firm has the integrity to turn down an offer when it challenges the independence of the company. Helena Herlogsson is of the opinion that most companies are very eager to make sure that the auditor is independent because "nobody wants to be the new Enron", as she expresses it.

6.1.4 EFFECTS ON PROFITABILITY

In order to see the effects of the regulation on the auditing firms, one tool is to look at the revenue distribution between audit and non-audit services. Most of the interviewees claim that the audit part of the revenues is the most important one. Peter Åkersten, company lawyer, refers us to an article in *Affärsvärlden* (Froste 2004) where Thomas Thiel, CEO of KPMG, states that at KPMG, audit services represent 80 per cent of total income. Olof Herolf, on the other hand, estimates that at Öhrlings PricewaterhouseCoopers, the revenues from audit and non-audit services are of equal size. There is a consensus among the interviewees that audit services are the base upon which the survival of the auditing firm is built. The auditor is often assigned for a period of four years and the price is determined in a contract, which makes it a stable source of income. The drawback to the audit services, according to some of the interviewees, is that there has been a downward pressure on prices for audit services. This pressure is explained by the fact that, before the Act was implemented, most companies hired the same auditing firm for auditing as well as for non-audit services. This situation meant that when competing against other auditing firms to get an auditing contract, the auditing firm could offer a low price because they knew that the non-audit services would generate more income. Michael Bernhardt suggests that price for an audit may be a less differentiating factor in terms of competitiveness than has been the case historically, as the new Act forbids the auditing firms to offer both forms of services to the same client.

When the interviewees were asked what they consider as more profitable, audit or non-audit services, the interviewees gave quite similar answers. The interviewees agreed that the audit contracts are very valuable as they usually last for a long period of time. The explanation is that the clients usually keep the same auditor and only change rarely. Considering that the audit contracts last for such a long time it is easier to plan the audit work and for this reason the auditing firms can keep low prices. The non-audit services projects, on the other hand, are usually shorter but more profitable. Two interviewees stress the importance of having the competence from the consultants to be able to perform a better audit. When looking at this factor, both audit and non-audit services are equally important for the auditing firm, even though the firms first and foremost are auditing firms. One of the problems with the non-audit services is that the demand for them varies greatly over time along with the state of the market while audit demand is approximately the same at all times.

6.1.5 EFFECTS ON COMPETITION

Today, the Big Four auditing firms dominate the audit industry both in Sweden and in the rest of the world. Most global companies therefore appoint one or more of the Big Four as their worldwide auditors because it makes the coordination of the auditing process easier. None of the interviewees thinks it likely that the requirement of the division between audit and non-audit services will make global companies more willing to hire non-Big Four auditing firms. One of the interviewees believes that this is due to the fact that the Big Four have greater knowledge in all parts of the audit field and that there might be uncertainty about the competence of smaller firms. Moreover, the issue of independence is more critical when a big company hires a small auditing firm, as the revenues from a big company could be crucial for the small auditing firm's survival. The interviewees agree, however, that the demand for division might make it easier for small firms, that have specialized in one particular non-audit service, to increase their share of the market. Michael Bernhardt says that he is under the impression that companies tend to be more rational nowadays and will hire the firm most suitable for a certain task. The prohibited non-audit services of the Sarbanes-Oxley Act are, by some of the interviewees, considered to increase the competition among the Big Four. Since the affected clients no longer are able to hire only one auditing firm, the market for audit and non-audit services has become more volatile. One interviewee viewed the provision of non-audit services as a way to get connections with the client and therefore increase the chance of being appointed auditor. It is easier to contact clients and ask them to use their auditing firm's non-audit services when the companies are aware of the rules of the Act. According to another interviewee, the increased competition decreases the willingness to recommend another firm for non-audit services. As stated by Olof Herolf, it is sometimes considered to be a problem that as few as four firms dominate the world audit market. There are situations where none of the Big Four is considered to be independent of a certain company, due to close relationships between auditor and company. This makes it difficult for a global company to find a suitable auditing firm. However, none of the interviewees thinks that it is likely that the number of the "Big Four" will increase.

6.1.6 EFFECTS OF THE PROPOSED EU REGULATION ON AUDIT

The European Union is currently working on a legislation that will be a response to the regulations of the Sarbanes-Oxley Act¹⁵. The interviewees have different opinions on the importance of such a law to the current work of implementing the rules of the Sarbanes-Oxley Act. Two of the interviewees state that their auditing firms monitor the development carefully and are preparing for the implementation, while the other two interviewees consider the EU legislation to be an issue in the distant future and ascribe little importance to it at the moment. One of the interviewees predicts that the EU legislation will have great impact on Swedish auditing firms. There are many Swedish companies, not currently affected by the Sarbanes-Oxley Act, which will be affected by the EU legislation. These companies are likely to need the assistance of the auditing firms when implementing the new EU rules.

¹⁵ See chapter 5 for a description of the proposed EU directive

6.2 INTERVIEWS WITH TOPIC-RELATED ACTORS

During the interviews with the representatives of the Big Four, all interviewees stated that the regulations of Section 201 do not have great impact on the activities of the auditing firms. This was not the impression that we had from the media before conducting the interviews. For this reason, we wanted more opinions on the subject. We therefore carried out four interviews with persons who have other perspectives than the representatives of the Big Four. The areas that were covered are Provided Services, Independence and Competition.¹⁶ The interviews were conducted with two journalists, one representative from Handelsbanken and one representative from Volvo, a company that is affected by the Sarbanes-Oxley Act. For the purpose of distinguishing this group from the representatives of the Big Four, the persons are referred to as *respondents* as opposed to the representatives of the Big Four who are referred to as *interviewees*.

All the topic-related actors believe that the auditing firms are going to be affected by Section 201 but they have different opinions on how it is going to affect the firms. Tord Jonerot, Head of Group Accounting at Handelsbanken, believes that the companies will be more careful when buying non-audit services from their auditor. In the past, the companies have used the auditors for many of the non-audit services but with the new law they will choose to hire someone else. The reason for this is not because they have seen the joint provision of audit and non-audit services as a problem in the past, but to avoid unwanted consequences. Calle Froste, a journalist at Affärsvärlden, is of the opinion that Section 201 is going to decrease the number of services the auditors can provide to a client. Fredrik Brunell, Vice President of Investor Relations at Volvo AB, believes that the profitability of the auditing firms will decrease when they can no longer provide non-audit services. He ascribes this decrease of profitability to the fact that companies, such as Volvo, pressure the prices of the auditing services downward while it is more difficult to affect the prices of the non-audit services. Finally, Per Lindwall, journalist at Dagens Industri, welcomes the new regulation as he is of the opinion that confidence in the auditors has been damaged since the scandals. He therefore asks for a clearer definition of what an auditor can and cannot do and calls for a decrease in the in-house non-audit services that the Big Four provide. Lindwall is confident that the Sarbanes-Oxley Act will accomplish this.

6.2.1 EFFECTS ON PROVIDED SERVICES

When asked about the effects that Section 201 will have on the non-audit services that the auditing firms provide, the respondents have different opinions. Two of the respondents, Tord Jonerot and Per Lindwall, are convinced that the auditing firms will sell fewer of the non-audit services. Lindwall also believes that it will be difficult for the auditing firms to provide all the services that they offer today and that they may have to split up their activities into different firms. Fredrik Brunell finds it difficult to determine whether or not the auditing firms will increase the sale of non-audit services. He does, however, believe that the prohibition of certain services will have a moderating effect on the escalation of provision of non-audit services that he witnesses today. Finally, Calle Froste thinks that the Big Four may start trading clients among each other be able to continue to provide non-audit services, which possibly could lead to an increased provision of non-audit services.

¹⁶ See Appendices V & VI for questionnaires

6.2.2 EFFECTS ON INDEPENDENCE

Regarding the issue of independence, the opinions of the respondents vary. The two journalists believe that Section 201 of the Sarbanes-Oxley Act will increase auditor independence. According to Per Lindwall, auditors claim that the non-audit services are necessary in order to carry out a good audit. Lindwall is, however, of the opinion that the issue of independence is of such a great importance that it outweighs other issues. Tord Jonerot also believes that Section 201 will improve independence but not as a result of tougher regulations. Instead he believes that the new rules attract attention to the issue of independence and that this focus will force the auditing firms to appear more independent. Jonerot is, however, eager to stress the fact that in his opinion lack of auditor independence has never been a big problem. Fredrik Brunell is also of the opinion that the issue of independence has not been a problem in the past and therefore he does not think that Section 201 will affect auditor independence. The insignificance of Section 201 mainly applies to the European situation and Brunell thinks that Section 201 may have impact on independence in the United States because American accounting rules are more detailed than European accounting rules. In the United States, he continues, the overall attitude is that if it is not prohibited, it is allowed, and therefore detailed regulations such as Section 201 are needed.

6.2.3 EFFECTS ON COMPETITION

All the respondents believe that the regulations of Section 201 will increase the possibilities for companies other than the Big Four to provide non-audit services. Tord Jonerot, for example, sees a trend where consultants leave the auditing firms and start their own separate businesses. He is also convinced that the opportunities for smaller companies have improved. Fredrik Brunell thinks that consultants will be separated from the auditing firms. Furthermore, Brunell says that companies such as Volvo will never hire smaller consultancy firms, as quality and reputation are very important factors for the credibility of the financial statements. Instead, Brunell suggests that there is a possibility that large consultancy firms, such as McKinsey, may widen their competence and offer the non-audit services that auditing firms offer today.

In this chapter we have presented the results of the interviews that have been carried out, structured into the six areas presented in the problem discussion. The following chapters will put this empirical research together with the theoretical framework to analyze and draw conclusions on the effects of Section 201.

7. ANALYSIS

In this chapter, the empirical information is analyzed from the theoretical framework established in chapters three through five. The analysis is structured in accordance with the six areas that the research is focused on.

The purpose of the analysis is to establish what effects Section 201 will have on the activities of Swedish auditing firms.

7.1 EFFECTS ON WAYS OF WORKING

The representatives of the auditing firms made it clear that the demand for division between audit and non-audit services does not have great effects on the way the work is carried out at the auditing firms. First, and foremost, the lack of effect is due to the fact that few of the Swedish auditors' clients are affected by the Sarbanes-Oxley Act. Second, the composition of the work teams is not affected by the new regulations since the teams for audit and non-audit services were separated even before the Act was passed. Also, the implementation of Section 201 demands much less work effort than other parts of the Act. Section 201 does not make requirements for changes in the way of working, other than that some non-audit services are no longer allowed to be performed for an audit client. Moreover, Section 201 includes no regulations of what services can be offered to non-audit clients. This situation decreases further the impact that Section 201 has on the auditing firms' ways of working.

To conclude, Section 201 has little effect on the auditing firms' ways of working. It does not affect their daily work, and only demands little increased work effort.

7.2 EFFECTS ON PROVIDED SERVICES

The services that the auditing firms provide can be divided into two groups, audit services and non-audit services. According to the definition of non-audit services in the Sarbanes-Oxley Act, non-audit services are services that are not directly related to the audit. As we have learned in the Theory chapter and the Empirical chapter, many believe that the provision of non-audit services improves the quality of the audit. According to Kinney et al. (2004), the audit quality improves as the auditor's knowledge of the company increases, and the auditor's knowledge of the company increases when performing non-audit services. The representatives of the Big Four also emphasize that if non-audit services were no longer provided, the auditing firm would lose their competence in such areas. Based on the discussion above, we do not believe that the auditing firms will decrease the range of services that they provide.

However, as stated in the Theory chapter, many researchers believe that the provision of non-audit services to an audit client could impair independence. Per Lindwall, journalist at Dagens Industri, supports this opinion as he believes that the in-house non-audit services that the Big Four provide are a threat to independence. Soltani (2004) mentions that auditors often gain a close relationship with management, which may make it more difficult for the auditor to criticize the financial statements. The issue of too close relationships with management is

something that is considered to have been a cause of the auditors' misjudgment in the Enron scandal as well as in the Skandia scandal. Also, as Firth (2002) emphasizes, the provision of non-audit services to an audit client increases the audit fees generated from that client, which may make the auditing firm economically dependent on the client. Such economic dependence is considered to have been one of the causes of the Andersen auditors' lack of independence during the Enron scandal. This evidence of how the provision of non-audit services to an audit client may impair independence indicates that there is a need to question what services the auditing firms should provide.

The decision on what services the auditing firm will provide the client is not up to the auditing firm to make. The auditor is appointed by the shareholders at the annual meeting and, as mentioned in the Empirical chapter, most companies are expected to keep their auditing firm for audit services and choose another firm for their non-audit services. Based on the statements of the representatives of the Big Four, we are of the opinion that it is likely that large companies will choose another one of the Big Four for their non-audit services as well. This could, as pointed out by Calle Froste at Affärsvärlden, lead to the situation where the Big Four will begin to exchange clients with each other. Moreover, there is a risk that the prohibitions of certain non-audit services of Section 201 will affect the possibilities for an auditing firm to provide an audit client with services that are not prohibited under the law. The example of tax services, mentioned in the Empirical chapter, illustrates this situation. It can therefore be expected that the regulations of Section 201 will, in effect, make non-audit services, other than the prohibited services, impossible to carry out for an audit client.

To conclude, because of the importance of the non-audit services to the quality of the audit, it is not likely that the range of services, offered by the auditing firms, will decrease. However, the threat that non-audit services pose to independence may have some effects on the possibilities for carrying out all services. Also, it is likely that non-audit services that are not prohibited under the Act may be considered to be impossible to carry out, because of their relation to the prohibited non-audit services. The importance of being regarded as an auditing firm, as opposed to a consultancy firm, has increased with the debate on auditor independence and non-audit services.

7.3 EFFECTS ON INDEPENDENCE

The main features of auditor independence are that the auditor is impartial, has no personal interests in the client's company and is not susceptible to pressure or influence. The purpose of the prohibited services of Section 201 is to help auditors sustain these principles. However, only three of the eight persons that we interviewed believe that Section 201 increases auditor independence. One of the main reasons for the skepticism towards the effects of the regulations is the existence of the Analysmodellen. As stated in the Theory chapter, the Analysmodellen forces the auditors to question whether or not the provision of a non-audit service to an audit client will impair their independence. This means that in situations where independence is threatened, the auditor must decline an offer to carry out a non-audit service. Therefore, the prohibited services of Section 201 were often not provided to auditor clients even before the implementation of the Sarbanes-Oxley Act. Based on this, we are of the opinion that the tools for being independent were present even before the Act was implemented.

According to Watts and Zimmermann (1979), as noted in the Theory chapter, auditor independence also depends on the auditor's ability to withstand any pressure from the client. Auditor independence therefore has to do with the auditor's character, as well as his or her competence. Auditor independence is not only a result of proper regulations; instead, as Olof Herolf points out, control of the auditor's judgment is equally important. The interpretation that can be made from this situation is that it is of great importance that the auditor wants to be independent, no matter what regulations are used. However, we believe that more detailed regulations on what services impair independence keep auditors from jeopardizing their independence. Clear guidelines may make it easier for the auditor to withstand pressure from the client; thus the decision about whether a service threatens independence is not entirely up to the auditor's judgment. This opinion is supported by one of the representatives of the Big Four, who believes that Section 201 improves independence as it removes all doubt about what services may decrease independence.

The discussion on independence has so far been focused on the actual independence of auditors, which, in the Theory chapter, is referred to as independence in fact. According to Hayes et al. (1999), it is equally important for the auditor to appear to be independent in the eyes of the public. Because the purpose of an audit is to lend credibility to the financial statements, the appearance that the auditor is not independent can make the users of financial statements distrust the information given. As some of the representatives of the Big Four state, the division of the audit and non-audit services may increase the confidence of the public, and if it does, then the Act has served a purpose. Based on this discussion, we are of the opinion that Section 201 may increase independence in appearance. However, with the new focus on independence issues, created by the scandals and enhanced by the Sarbanes-Oxley Act, the provision of many non-audit services, not prohibited under the Act, will be questioned. Therefore, Section 201 may also, indirectly, make it impossible for auditors to provide other non-audit services to audit clients.

To conclude, our opinion is that, because of the presence of the Analysmodellen, independence in fact will not increase with the regulations of Section 201. However, because of increased attention and knowledge, independence in appearance may increase since Section 201 may give the impression that it prevents auditors from endangering their independence.

7.4 EFFECTS ON PROFITABILITY

Most of the representatives of the Big Four claim that the audit part of the revenues is more important than the non-audit part. Non-audit services are considered to be more profitable, but the contracts for audit services usually last for several years and are therefore considered to be more secure. Also, the demand for audit services is not as dependent on the economic situation as the demand for non-audit services is. The audited companies are, as stated above, expected to keep their auditing firm for audit services and find another firm for non-audit services. This situation implies that the provision of audit services continues to be a more stable source of income than the provision of non-audit services.

Section 201 of the Sarbanes-Oxley Act may also have effects on audit, as well as non-audit, fees. According to some of the representatives of the Big Four, the prices of audits have been pressured downward in the past. As the auditing firms previously decreased the prices of audit services in order to also be the one to provide non-audit services, it is likely that audit fees will increase, now that joint provision is no longer possible. However, as Fredrik Brunell

points out, large companies also have great influence on the size of the audit fees, which implies that the prices of audit will not increase significantly in the near future. On the other hand, with the new competition for non-audit services, the fees for such services are likely to decrease due to more competitors in the market.

To conclude, audit is still the main source of revenues for the auditing firms, and is the basis of the auditing firms' activities. However, the profitability of the services can be expected to be affected by the regulations of Section 201. Audit fees may increase, as the provision of audit services no longer leads to the provision of non-audit services. Non-audit fees are instead likely to decrease with the increased competition in the market for non-audit services.

7.5 EFFECTS ON COMPETITION

Since the companies can no longer hire the same auditing firm for both services, the competitive situation for the auditing firms is likely to change. As the provision of audit services no longer leads to the provision of non-audit services, the auditing firms must find other ways to attract clients to their non-audit services. We believe that this situation is likely to increase the competition among the auditing firms.

Moreover, the competition could increase further since it may become easier for other firms to enter the market, as companies are forced to evaluate what auditing firms to use. The representatives of the Big Four do not think it likely that large companies will hire smaller auditing firms for their audits, but they do think it is possible for firms that have specialized on a certain non-audit service to enter the market. However, Fredrik Brunell claims that Volvo would never hire a small firm for their non-audit services. Instead, Brunell predicts that the new character of the market for non-audit services could attract big consultancy firms that broaden their supply of services to also cover non-audit services. These consultancy firms are likely to pose a bigger threat to the Big Four than smaller firms, since they, like the Big Four, are represented around the world. Based on the discussion above we believe that the market for non-audit services will not be dominated by the Big Four to the same extent as it was before the implementation of the Sarbanes-Oxley Act. We believe that competition will increase as large consultancy firms from related markets and smaller specialized firms enter the market. The dominance of the audit market is, however, likely to remain.

To conclude, the regulations of Section 201 are likely to increase competition among the Big Four. Also, it can be expected that more competitors will enter the market for non-audit services, while the audit market probably will remain the same.

7.6 EFFECTS OF THE PROPOSED EU DIRECTIVE ON AUDIT

Concerning the effects of the new proposal for an EU Directive on statutory audits, the representatives of the Big Four have very different views. It was very interesting to learn that the expectations on the impact of the new regulations differ to a great extent. There are two ways to approach the issue. On one hand, if the proposal is approved as it is formulated today, it will, as stated in the Regulations of Auditing chapter, be similar to the Analysmodell that currently regulates the Swedish auditor profession. Therefore, the implementation of the new regulations should not cause great changes in the activities of Swedish auditing firms. On the

other hand, since the Sarbanes-Oxley Act and the proposed EU Directive are considered to have the same purpose, comparisons are likely to be made. However, the EU Directive proposal does not, in opposition to the Sarbanes-Oxley Act, dictate what services are prohibited. This could lead to a situation where the non-audit services that are prohibited according to Section 201 of the Sarbanes-Oxley Act will become the unofficial guidelines on how the EU regulation should be interpreted. As stated in the Regulations of Auditing chapter, all Swedish companies must follow the rules of any new EU Directive. Therefore, there is a possibility that the prohibited services of Section 201 will be considered prohibited for all Swedish companies in the eyes of the public.

To conclude, the EU regulation, if adopted, may not have great impact on the activities of the auditing firms, as the rules are not likely to differ from the Analysmodellen that regulates their activities today. However, there is a possibility that the prohibited services of Section 201 will affect the interpretation of the EU regulations.

In this chapter we have analyzed the results from the empirical research in order to establish the effects of Section 201 in the six different areas that we have focused on.

In the next chapter we will emphasize the conclusions that the analysis has resulted in and present an answer to the main problem.

8. CONCLUDING DISCUSSION

In this chapter, we will, in accordance with the purpose of the thesis, present the conclusions that have been drawn from the analysis. First, the effects on the different areas are discussed and thereafter we will answer the main problem of the thesis:

What effects will the division of audit and non-audit services in Section 201 of the Sarbanes-Oxley Act have on Swedish auditors' activities?

The chapter ends with some suggestions for further research.

8.1 CONCLUSIONS

In this section, the effects on the six areas that are outlined in the Problem discussion of chapter 1 are evaluated in order to answer the main problem.

8.1.1 EFFECTS ON WAYS OF WORKING

The Ways of Working is the area that is affected the least by Section 201 of the Sarbanes-Oxley Act. The work teams for audit and non-audit services were separated even before the Act was passed and therefore the composition of the work teams is not affected. Also, the implementation of Section 201 does not involve much additional work effort.

8.1.2 EFFECTS ON PROVIDED SERVICES

The range of services provided by the auditing firms is not likely to decrease. The auditing firms are convinced that the non-audit services that they provide improve the quality of the audit and the non-audit services are therefore necessary for the competence of the auditor. The provision of non-audit services to an audit client is, however, also considered to pose a threat to the auditor's independence. This situation forces the auditors to consider what services they will provide to the audit client. Moreover, the prohibition of certain services, such as legal advice, may make it impossible to carry out services that are not prohibited, as even the allowed non-audit services may result in the need for legal advice. The importance of being regarded as an auditing firm, as opposed to a consultancy firm, has increased with the debate on auditor independence and non-audit services, and therefore the auditing firms must evaluate the services that they offer.

8.1.3 EFFECTS ON INDEPENDENCE

The main purpose of Section 201 of the Sarbanes-Oxley Act is to ensure auditor independence. We are of the opinion that the independence of Swedish auditors is not improved by the regulations of Section 201, as the existence of the Analysmodellen ensured independence even before the Act was passed. However, even if the auditor is independent,

this is not sufficient if the users of the financial statements do not believe that the auditor is independent. Therefore, the prohibition of certain services in Section 201 of the Act may improve confidence in the auditor. It is easier for the public to believe that the auditor is independent if there are strict regulations, as opposed to if the auditor's independence is based on his or her judgment. The effect that Section 201 has on independence is therefore that it strengthens the appearance that the auditing firms are independent.

8.1.4 EFFECTS ON PROFITABILITY

We do not believe that Section 201 of the Sarbanes-Oxley Act will affect the auditing firms' revenue distribution between audit and non-audit services to a large extent. Auditing has been, and is likely to remain, the most important and stable source of income for the auditing firms. However, changes can be expected in the prices of both kinds of services. The auditing firms may raise their audit fees when it is no longer possible to provide the non-audit obtained by lowered audit fees. Also, the expected increased competition for non-audit services is likely to decrease the prices of non-audit services. Therefore, Section 201 may have effects on the profitability of the auditing firms.

8.1.5 EFFECTS ON COMPETITION

We are of the opinion that the prohibition of certain non-audit services in Section 201 of the Sarbanes-Oxley Act is likely to increase the competition among the Big Four. This opinion is based on the fact that non-audit services are no longer connected to the provision of audit and therefore the auditors must find other ways to attract clients for the non-audit services. Moreover, we believe that more competitors will enter the market for non-audit services. These competitors may include consultancy firms from related markets and smaller firms that are specialized on a certain non-audit service. However, we do not think it likely that the competition from small audit firms will be a threat to the dominance of the Big Four.

8.1.6 EFFECTS OF THE PROPOSED EU DIRECTIVE ON AUDIT

The proposed EU Directive is similar to the Analysmodellerna and will therefore, if implemented, not cause great changes in the activities of the Swedish auditing firms. However, the rules of the proposed Directive will be compared to the regulations of the Sarbanes-Oxley Act, due to the fact that both regulations aim to increase confidence in the audit process. The EU proposal does not contain clear regulations on what services impair independence. We are therefore of the opinion that there is a possibility that, when the EU Directive is implemented, the prohibited services of Section 201 will affect the interpretation of what services should not be provided to an audit client under the EU Directive.

8.1.7 MAIN PROBLEM

What effects will the division of audit and non-audit services in Section 201 of the Sarbanes-Oxley Act have on the activities of Swedish auditing firms?

We have drawn the conclusion that Section 201 of the Sarbanes-Oxley Act will not have great effects on the activities of Swedish auditing firms.

However, there are areas that are likely to be affected, indirectly, by the demand for division between audit and non-audit services. These areas are audit fees, the perception of the auditing firms' independence and the competition in the market for non-audit services. Also, the impact of Section 201 may increase if the proposal for a new EU Directive on statutory audit is passed.

8.2 FURTHER RESEARCH

For further research on this subject, we suggest the following:

- As mentioned in the Regulations on Auditing chapter, the provision of tax services is not prohibited in Section 201 of the Sarbanes-Oxley Act. For what reasons are tax services not prohibited, and what effects will it have on auditor independence?
- This thesis is written from the auditors' point of view. It would, therefore, be of great interest to investigate what effects the regulations of Section 201 will have on the Swedish companies that are affected by the Act.
- The issue of independence is always timely. We suggest a study of the public's opinion of auditor independence and how it has been affected by the recent scandals and the implementation of the Sarbanes-Oxley Act.

9. LIST OF REFERENCES

LITERATURE

Andersen, I. 1998, *Den uppenbara verkligheten – val av samhällsvetenskaplig metod*, Studentlitteratur, Lund.

Arbnor, I. & Bjerke, B. 1994, *Företagsekonomisk metodlära*, Studentlitteratur, Lund.

Eriksson, L. T. & Wiedersheim-Paul, F. 2001, *Att utreda forska och rapportera*, Liber Ekonomi, Malmö.

Hayes, R., Schiller, A., Dassen, R. & Wallage, P. 1999, *Principles of Auditing: An International Perspective*, McGraw-Hill, Glasgow.

Holme, I. M. & Solvang, B. K. 1997, *Forskningsmetodik – Om kvalitativa och kvantitativa metoder*, Studentlitteratur, Lund.

Mautz, R.F. & Sharaf, H. A. 1961, *The Philosophy of Auditing*. American Accounting Association, Sarasota, Fla.

Porter, B., Simon, J. & Hatherly D. 1996, *Principles of External Auditing*, John Wiley & Sons, Trowbridge.

Smith, D. 2000, *Redovisningens språk*, Studentlitteratur, Lund.

Svernlöv, C. & Blomberg, E. 2003[a], 'Sarbanes-Oxley – största värdepapperslagstiftningen på 70 år' in *Ny juridik 1:2003*, VJS, Stockholm.

Trost, J. 1997, *Kvalitativa Intervjuer*, Studentlitteratur, Lund.

ARTICLES AND REPORTS

Bartlett, R.W. 1991, 'A Heretical Challenge to the Incantations of Audit Independence', *Accounting Horizons*, vol. 5, no.1, pp. 11-16.

Beck-Friis, U. 2003, "'Kunskapen om revisorns roll är helt otillräcklig'", *Svenska Dagbladet*, December 8.

Coustan, H., Leinicke, L. M., Rexroad, W. M. & Ostrosky, J. A. 2004, 'Sarbanes-Oxley: What it Means to the Marketplace', *Journal of Accountancy*, February pp. 43-47.

Firth, M. 2002, 'Auditor-Provided Consultancy Services and their Associations with Audit Fees and Audit Opinions', *Journal of Business Finance & Accounting*, vol. 29, no. 5 & 6, pp. 661-693.

Froste, C. 2004, 'Vinnarna på skandalerna', *Affärsvärlden*, vol.104, no. 20, pp.38-40

Kinney Jr., W. R., Palmrose, Z-V. & Scholz, S. 2004, 'Auditor Independence, Non-Audit Services, and Restatements: Was the U.S. Government Right?', *Journal of Accounting Research*, vol. 42, no.3, pp. 561-588.

Pany, K. & Reckers, P. M. J. 1984, 'Non-Audit Services and Auditor Independence – A Continuing Problem', *Auditing: A Journal of Practice & Theory*, vol. 3, no. 2, pp. 89-97.

Reinstein, A. & Weirich, T.R. 2002, 'Accounting Issues at Enron', *CPA Journal*, vol. 72, no. 12, pp. 20-25.

Sharma, D. S. & Sidhu, J. 2001, 'Professionalism vs Commercialism: The Association Between Non-Audit Services (NAS) and Audit Independence', *Journal of Business Finance & Accounting*, vol. 28, no. 5 & 6, pp. 595-629.

Sunden, M. 2003, 'Skandiauppdraget var komplext och ovanligt', *Svenska Dagbladet*, December 29.

Svernlöv, C. & B:son Blomberg E. 2003[b], 'Sarbanes-Oxley Act – USAs hårda svar på redovisningsskandalerna', *Balans* no 1 pp. 23-28.

Thomas, C.W. 2002, 'The Rise and Fall of Enron', *Journal of Accountancy*, vol. 193, no. 4, pp. 41-47.

Wallerstedt, E. 2001, 'The Emergence of the Big Five in Sweden', *The European Accounting Review*, vol. 10, no. 4, pp. 843-867.

Watts, R. & Zimmerman, J. 1979, 'The Demand for and Supply of Accounting Theories: The Market for Excuses', *Accounting review*, vol. 54, April, pp. 273-305.

Zeff, S.A. 2003, 'How the U.S. Accounting Profession Got Where It Is Today: Part II', *Accounting Horizons*, vol. 17, no. 4, pp. 267-286.

INTERNET

Deloitte

[a]: http://www.deloitte.com/dtt/section_node/0,2332,sid%3D8104,00.html

[read 2004-05-15].

[b]: http://www.deloitte.com/dtt/section_node/0.2332,sid%253D19354,00.html [read 2004-05-28].

Ernst & Young

[a]: http://www.ey.com/global/content.nsf/Sweden/Om_EY_Fakta [read 2004-05-15].

[b]: http://www.ey.com/global/content.nsf/International/About_EY_-_Key_Facts_and_Figures_-_History [read 2004-05-18].

FAR – Föreningen Auktoriserade Revisorer

[a]: http://www.far.se/pdf/040316.8thDirective_en.pdf [read 2004-04-20].

[b]: <http://www.far.se/artikel.asp?id=281&page=1> [read 2004-04-20].

[c]: <http://www.far.se/doc/Analysmodellen4.doc> [read 2004-06-02]

KPMG

<http://www.kpmg.com/about/history.asp> [read 2004-05-15].

NASDAQ

<http://www.nasdaq.com/asp/NonUsOutput.asp?page=S®ion=europe> [read 2004-04-19].

The Sarbanes-Oxley Act

<http://www.sarbanes-oxley.com/>. [read 2004-04-19]

Skandia

<http://www.skandia.com/se/ourbusiness/ourbusiness.shtml> [read 2004-06-03]

<http://www.skandia.se/omskandia/omskandia.jsp> [read 2004-06-03]

Öhrlings PricewaterhouseCoopers

<http://www.pwcglobal.com/se/swe/carees/historik.html> [read 2004-05-15].

OTHER MATERIAL

Blix, C., Danielsson, Å., Nihlén, J-H. & Åkersten, P. 2002 *Sarbanes-Oxley Act: Utredning på uppdrag* av FAR, Oct. 7.

Public Law 107-204 107th Congress, H.R. 3763, *The Sarbanes-Oxley Act of 2002*, July 30, 2002

Sarbanes-Oxley: A Closer Look 2003, KPMG LLP, January.

Soltani, B. *Auditing*, working title. Unpublished manuscript pending publication at Pearson Education Ltd, Harlow. 2004

INTERVIEWS

Bernhardtz, Michael. Consultant at Deloitte, Stockholm. Personal interview, May 3, 2004.

Brunell, Fredrik. Vice president of Investor Relations at Volvo AB, Göteborg. Telephone interview, June 4, 2004,

Froste, Calle. Journalist at Affärsvärlden, Stockholm. Telephone interview, June 2, 2004.

Herlogsson, Helena. Auditor at Ernst & Young, Göteborg. Personal interview, April 28, 2004.

Herolf, Olof. Auditor at Öhrlings PricewaterhouseCoopers, Stockholm. Personal interview, May 21, 2004. The interview took place in Göteborg

Jonerot, Tord. Head of group accounting at Handelsbanken, Stockholm. Telephone interview, June 2, 2004.

Lindwall, Per. Journalist at Dagens Industri, Stockholm. Telephone interview, June 2, 2004.

Åkersten, Peter. Company lawyer at KPMG, Stockholm. Personal interview, May 13, 2004.

Public Law 107-204- JULY 30,2002

TITLE II- AUDITOR INDEPENDENCE

SEC.201 SERVICES OUTSIDE THE SCOPE OF PRACTICE OF AUDITORS

(a) **PROHIBITED ACTIVITIES.**- Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1) is amended by adding at the end of the following:

“(g) **PROHIBITED ACTIVITIES.**-Except as provided in subsection (h), it shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit required by this title or the rules of the Commission under this title or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 101 of the Sarbanes-Oxley Act of 2002 (in this section referred to as the ‘Board’), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including-

“(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

“(2) financial information systems design and implementation;

“(3) appraisal of valuation services, fairness opinions, or contribution-in-kind reports;

“(4) actuarial services;

“(5) internal audit outsourcing services;

“(6) management functions or human resources;

“(7) broker or dealer, investment adviser, or investment banking services;

“(8) legal services and expert services unrelated to the audit; and

“(9) any other services that the Board determines, by regulation is impermissible.

“(h) **PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES.** A registered public accounting firm may engage in any non-audit service, including tax services, that is not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i).”.

(b) **EXEMPTION AUTHORITY.**- The Board may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on provision of services under section 10A(g) of the Securities Exchange Act of 1934 (as added by this section), to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, and subject to review by the Commission in the same manner as for rules of the Board under section 107.

Questionnaire, Big Four

Interview regarding the Sarbanes-Oxley Act and it's requirement of division between auditing and non-related services.

- What are your experiences of the Sarbanes-Oxley Act?
 - Which companies, affected by the Sarbanes-Oxley Act, does your auditing firm audit?
 - What preparations has your auditing firm offered its employees for the implementation of the Sarbanes-Oxley Act.

 - How is a work team constructed?
 - In what way is the construction of the team affected by the Sarbanes-Oxley Act's requirement of division between auditing and non-related services.
 - Do you look upon the requirement of division between auditing and non-related services as an opportunity or a threat, and for what reason?
 - In what way do you notice the division between auditing and non-related services in your daily work?
 - How will the division between auditing and non-related services affect auditor independence and impartialness?

 - To what extent do your clients continue to use your auditing services and hire someone else for the non-related services?
 - Is the decision made in concord with you and the client or is it entirely up to the company to choose?
 - What do you think about the possibility that clients will choose to hire companies with special competence for the non-related services instead of on of the Big four?

 - What is the income division between auditing and non-related services today?
 - How do you think the division is going to be in the future?
 - If it was up to the auditing firm to choose between offering the client auditing services or non-related services, what criteria apart from the income division determines the choice?
 - Do you think that there is a trend towards more focus on auditing or on non-related services, and if so why?
 - How do you think the division between auditing and non-related services will affect the relationship between the Big four?
 - The European Union has presented a proposal on/for a similar legislation. In what way does this legislation affect the way you handle the Sarbanes-Oxley Act's division between auditing and non-related services?
-

Intervjufrågor, Big Four.

Intervju angående Sarbanes-Oxley Act och dess krav på uppdelning mellan revision och icke-relaterade tjänster.

- Vilka är Dina erfarenheter av Sarbanes-Oxley Act?
 - Vilka företag som påverkas av SOA reviderar XXXX?
 - På vilket sätt har man på XXXX förberett sina anställda för hanteringen av SOA?

 - Hur är ett arbetsteam uppbyggt?
 - Hur påverkas teamens utseende av SOAs krav på uppdelning mellan revision och icke-relaterade tjänster?
 - Ser Ni kravet på uppdelning mellan revision och icke-relaterade tjänster som ett hinder eller en möjlighet, och av vilken anledning?
 - På vilket sätt märker Ni av uppdelningen mellan revision och icke-relaterade tjänster i det dagliga arbetet?
 - Hur tror Du att uppdelningen kommer att påverka revisorernas oberoende och opartiskhet?

 - I hur stor utsträckning väljer klienter att fortsätta anlita Er för revision och tilldelar ett annat företag de icke-relaterade tjänsterna?
 - Är det ett beslut som fattas i samförstånd mellan Er och klienten eller är det helt och hållet företaget som avgör?
 - Vad tror Du om möjligheten att klienter väljer att anlita mer specialinriktade företag för de icke-relaterade tjänsterna i stället för något av de stora fyra revisionsföretagen?

 - Hur ser intäktsfördelningen mellan revision och övriga tjänster ut idag?
 - Hur tror Du att fördelningen kommer att vara i framtiden?
 - Om det hade varit upp till revisorsfirman att välja mellan att förse en klient med revision eller med övriga tjänster, vilka kriterier förutom intäktsfördelningen avgör?
 - Tror Du att utvecklingen kommer att gå mot att man fokuserar mer på antingen revision eller övriga tjänster, och i så fall, varför?
 - Hur tror Du att uppdelningen mellan revision och icke-relaterade tjänster kommer att påverka förhållandet mellan de stora fyra revisionsföretagen?
 - EU har ju lagt fram ett förslag på motsvarande lagstiftning. På vilket sätt påverkar det hur Ni hanterar SOAs krav på uppdelning mellan revision och icke-relaterade tjänster?
-

Presentation of Representatives of the Big Four

Helena Herlogsson, ERNST & YOUNG, Gothenburg, April 28, 2004, 13:00-13:45

Helena Herlogsson has been working as an auditor for 13 years and she received her authorization in 1995. She works as senior manager and has been working at ERNST & YOUNG for the last two years. Before that, she worked for Arthur Andersen. Helena Herlogsson works with listed companies, among which are Lear Corporation and Kronans Droghandel. She has attended a number of in-service trainings on the topic of the Sarbanes-Oxley Act.

Michael Bernhardt, Deloitte, Stockholm, May 3, 2004, 09:00-10:00

Michael Bernhardt is a senior manager at Deloitte. He has been working in the audit business for eight years, at first at Andersen and since 2002 at Deloitte. Michael Bernhardt works as a consultant, and is responsible for a group of 10-12 employees that offers services on internal audits and risks. They mainly work with section 404 concerning internal controls, as this part requires most resources. The group assists the companies in the implementation of the changes that are required by the Act. Among the companies he works with are SKF and Concordia. Michael Bernhardt has also participated in in-service trainings on the topic of the Sarbanes-Oxley Act.

Peter Åkersten, KPMG, Stockholm, May 13, 2004, 09:00-10:00

Peter Åkersten works as company lawyer, and was hired by KPMG in 2001. He mainly works with internal advice and issues of independence. For the moment, much of his time is taken up by the auditor registration with the PCAOB. Peter Åkersten was also one of the co-authors of an investigation of the Sarbanes-Oxley Act, requested by FAR.

Olof Herolf, Öhrlings PricewaterhouseCoopers, Gothenburg, May 21, 2004, 13:30-14.30

Olof Herolf is an authorized auditor and partner at Öhrlings PricewaterhouseCoopers, where he has worked since 1970. Formerly, Olof Herolf was CEO of Price Waterhouse in Sweden and after the merger with Öhrlings Coopers & Lybrand, he continued as CEO for the new firm. He is a member of the board of directors of FAR and between 1990 and 1992 he was chairman of the board. Today he is responsible for the Assurance Business Advisory Services division at Öhrlings PricewaterhouseCoopers and is in charge of the coordination of the adjustment to the Sarbanes-Oxley Act. Olof Herolf is one of the lead auditors of Volvo AB and has also worked with Ericsson, Swedish Match and SKF.

Questions, telephone interviews

1. How do you think Section 201 is going to affect the activities of the auditing firms?
 2. How is that going to affect the independency?
 3. Do you believe that companies with great knowledge in certain areas (for example, in formulating computer programs or actuarial issues) or smaller auditing firms are going to find it easier to enter the market because of the regulations of Section 201?
 4. Do you think that the auditing firms are going to sell more or less of the consultancy services because of the legislation.
-

Frågor, telefonintervjuer

- 1 Hur tror du att Section 201 kommer att påverka revisorsfirmornas verksamhet?
 2. Hur kommer det att påverka oberoendet?
 3. Tror du att företag med specialkunskap (inom t.ex utformning av dataprogram eller aktuariefrågor) eller mindre revisionsfirmor kommer att få lättare att komma in på marknaden i och med reglerna i Section 201?
 4. Tror du att revisionsföretagen kommer att sälja mer eller mindre av konsulttjänster på grund av lagstiftningen
-