

Audit in a Turbulent Environment

- Effects on Audit due to the Financial Crisis & Criticism



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Abstract

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Background & Problem description: Audit is an important part of the market economy. The auditors rely on the confidence of stakeholders and when distrust occurs it may have harmful consequences. The financial industry is as well an important part of the market economy seeing that it enables growth possibilities. Confidence in the financial industry is a necessity for a functioning and stable economy. Confidence is enhanced with audit, through their professional skepticism when reviewing financial statements stakeholders base their decisions on. When a crisis hits the global economy the disturbance in the financial market threatens confidence in the financial sector. This became the consequence of the financial crisis of 2008. Auditors have been challenged and criticized in the aftermath of the financial crisis and given their importance in the market economy, changes are being discussed both in audits and the system they are obliged to. Furthermore, the confidence in the financial companies and their financial statements is decreasing due to the criticism towards auditors. The loss of reliability for the financial industry can have harmful consequences, thus the importance of the auditors reviewing the financial industry correctly.

Purpose: The research aim is to examine the practical work and behavior of auditors and how it may have been altered due to the financial crisis and the recent criticism towards the auditors.

Demarcation: A limitation is made to auditors working with financial companies, mainly banks. Focus lays on auditors' perspective and not accounting regulations.

Method: In order to understand the relationship between the financial crisis and changes in audit, a qualitative method is used. Interviews have been conducted with six chartered auditors working with financial companies in order to build up the empirical findings. Statutory frameworks and related articles have been used in order to build up the theoretical framework.

Conclusion: Pervading changes and effects have not occurred throughout the entire practical work of an auditor. However, the financial crisis and criticism has affected parts of the practical work and therefore an effect has after all occurred. Auditors' behavior is as well affected by the financial crisis and the recent criticism. Higher requirements on documentation, increased focus on internal control, and specialization are examples on changes made due to the financial crisis and criticism.

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1 Introduction

The first chapter presents a background of the topic where the financial crisis and criticism towards auditors are introduced, followed by a problem discussion, research aim and research question as well as a presentation of the demarcation.

1.1 Background

Organizations establish financial statements with information about their financial position and performance for several external users, for instance shareholders, lenders, employees, and the state. The financial statements provide the stakeholders with important information useful for their business decisions. The information in the financial statements may be the only information that stakeholders will obtain and therefore, the function of the financial statement is important for the stakeholders. (Smith 2006)

It is necessary for the stakeholders to know that they can trust the financial statements given by the companies, thus the work of an auditor is important for stakeholders (Far förlag 2006). It would be impossible for every single stakeholder to become involved in the control of the management and therefore the stakeholders need to implement a mechanism to protect their interests. This mechanism is auditing. With the function of auditing there is no need for the stakeholders to make their own review of the financial statement, seeing that they trust the work of audit. The auditor relies on the confidence of the stakeholders and when distrust occurs it may have harmful consequences. (Dunn 1996)

The Swedish Minister for financial markets, Peter Norman expressed the following opinion: *“I believe that a good audit is the cornerstone of all business activity, not least for financial companies”¹ (Norman 2011)*

An important function in the market economy is the financial industry, seeing that it enables companies to evolve and expand. Confidence in the financial industry is important for the companies as well as the public, and the confidence is enhanced through audit. Audit plays an important role in the financial industry. Together with regulators and managers they reassure stakeholders of correct establishment of financial statements and they provide stability in the economy (Europeiska kommissionen 2010).

The importance of a stable financial market in the economy is significant. When a crisis hits the global economy the disturbance in the financial market threatens confidence in the financial sector. This became the consequence of the financial crisis of 2008. (Lindgren 2011) The global crisis of 2008 had its origin in the real estate market in the U.S. Due to the global spread of securities from the real estate market in the U.S, a global crisis developed fast. Lack of confidence in the financial institutes spread as well as higher interest rate globally, while a decrease in risk appetite caused a global fall in the stock markets. (Österholm 2010) The Swedish economy is, as well as other countries, deeply dependent on the surrounding world and the world economy. During 2009 the Swedish GDP fell by five percentages, the largest decline since World War II (Konjunkturinstitutet (KI) 2009). As the uncertainty in the financial market developed, higher interest rates followed as a security for banks due to the increased risk (Rosén 2008). The Swedish stock market fell in the beginning of 2008 and even if the bank system, with help from the central bank, did not experience a great risk of a financial collapse, the bank system did experience losses. The Swedish banks especially experienced losses in

¹ Original Swedish quote: *“Jag menar att god revision är en hörnsten för all företagsamhet, inte minst för finansiella företag.”*

the Baltic States (Österholm 2010). Swedbank is one of the big Swedish banks which experienced great losses due to the severe effect on the Baltic States during the financial crisis (Ström 2009). The increased risk had several effects in the financial market but one severe problem that occurred was the increasing distrust between banks which led to liquidity shortage. Distrust threatened the stability of the financial market (Bäckström & Forsell 2008). Traces of the crisis are still present even though they are not as crucial and severe, and it is still a topic of discussion.

Auditors are important in the financial market and have the ability to contribute to a stable economy. However, auditors were challenged in the aftermath of the financial crisis. They have been questioned in their approval of banks' financial statements during the crisis which resulted in the banks' losses (Europeiska kommissionen 2010). Auditors have received criticism from the audit inspection unit in the UK, a part of the FRC in the UK, for not showing enough skepticism when performing audit on internal asset valuation and not challenging the management sufficiently (Sukhraj 2010). They are no longer considered to be innocent in the context of the financial crisis. The role of accounting has been criticized by Jan Marton in an article in "Dagens Industri". According to Marton, lack of transparency in accounting and difficulties in valuation of financial instruments may have resulted in the depth of the crisis. Due to the drawbacks in accounting, trust issues among banks arose and unwillingness to cooperate with each other followed (Marton 2008). The Financial Services Authority, which regulates the financial services industry in the UK, believes that the confidence in the financial companies and their financial statements is decreasing due to the criticism towards auditors. Overall, criticism towards auditors is a fact, and given their importance in the market economy changes are being discussed both in audits and the regulatory system they adhere to. (Sukhraj 2010)

1.2 Problem discussion

Auditors are obliged according to a statutory framework to ensure quality in companies' accounting. In cases where auditors are questioned distrust may occur, not only for the audit business but furthermore for the companies being monitored (Danielsson 2011). The Swedish minister for financial markets, Peter Norman, states following which stresses auditors' importance:

*"If the audit profession is not functioning, the market economy will die"*² (Norman 2010)

Distrust may interfere with cooperation between companies and banks, preventing banks from lending money to each other as well as to other parties (Marton, 2008). A controversial company in question is HQ Bank AB. Numerous questions and opinions awoke when the bank's crisis appeared and the deficiencies in their accounting were discovered. HQ Bank's permit to operate in the financial market in Sweden was withdrawn by The Financial Supervisory Authority (FI), and FI applied for the company to enter into liquidation. These consequences followed owing to inaccurate reporting of the bank's financial position. An investigation is currently examining whether HQ Bank's trading portfolio was overvalued, which would indicate that HQ Bank was undercapitalized since December 2008. (Håkansson & Westerberg 2010) The auditor of HQ bank received harsh criticism due to the fact that he did not have any remarks on the financial statement. FI reported the auditor of HQ bank to the Supervisory Board of Public Accountants (RN). (Östlund 2010)

The financial industry is crucial for a functioning and effective economy, hence significant for the public. The loss of reliability for financial institutes can have harmful consequences, thus the importance of the auditors reviewing the financial industry correctly with regulations adapting to the fluctuating economy. As we pointed out above the auditors are an important element in the market

² Original Swedish quote: *"Fungerar inte revisionsbranschen, då dör marknadsekonomi helt"*

economy and it is of great importance that the review works well and that audit is trustworthy. Therefore we find this to be an interesting subject and want to examine if the audit business have followed with alterations in order to improve audit.

1.3 Research aim

The research aim is to examine auditors working with the financial service sector in Sweden, and how their practical work and behavior may have been altered due to the financial crisis and the recent criticism towards auditors. Furthermore, we will discuss whether the criticism has affected the confidence in the audit business and if the auditors are better equipped for future disturbances in the financial market.

1.4 Problem statement

In order to reach the aim of our research we raise following questions:

How has the financial crisis and the recent criticism affected the auditors' behavior and practical work and which changes have been made in the practical work of an auditor due to the financial crisis and recent criticism?

1.5 Demarcation

In order to reach our research aim we have chosen to interview auditors working with the financial industry, mainly banks. The recent criticism towards auditors has mostly been within the financial industry and therefore we find this demarcation suitable. Our focus is on the auditors and their perspective on the research problem. We are not examining changes in regulation due to the financial crisis, but we do use relevant regulations in order to build our theoretical framework and understand the collected empirical material.

2 Method

Chapter two presents the choices and approaches conducted in this study. A presentation of the research method and data collection is given, followed by a description on the execution of the analysis. Furthermore, validity, credibility and criticism of the sources are discussed.

Method is a systematic approach which enables the reader to understand the writer's execution in the examination and facilitates the reader's own evaluation of the result. When choosing an appropriate research method it is important that the method is compatible with the aim of the research question. (Rienecker & Jørgensen 2004)

2.1 Qualitative research method

The research aim and question in our study requires examination of auditors' work, but more importantly understanding changes in auditors' behavior due to the financial crisis. To understand the relation between possible changes and the financial crisis we will use a qualitative research method. Qualitative research is characterized by interpreting behavior (Hartman 2004). This method focuses more on understanding the problem in question (Andersen 1998). We have conducted interviews in order to understand our problem and reach our aim. With a theoretical framework and the empirical data collected we have been able to obtain a greater understanding of auditors' review behavior.

2.2 Data collection

A common qualitative research method is conducting interviews. Interviews are useful when you want to understand an individual's thoughts considering a problem or a phenomenon. (Jacobsen 2002) Our main focus with the research is to understand and examine whether auditors' behavior and practical work has changed and therefore we consider interviews to be the best research design for our study. The use of individual interviews will enable us to understand the individual auditor's thoughts on changes in audit. We are interested in the point of view of auditors working with the financial sector, mainly banks.

In order to perform a qualitative interview and understand as well as be able to analyze the answers given, we need to establish a theoretical framework. The theoretical framework contains the statutory framework auditors adhere to, mostly limited to the audit process. We use the theoretical framework in order to understand the practical work of the auditor and possible changes. Auditors follow the International Standard on Auditing (ISA) from January 2011. Therefore we have chosen to look into ISA, and not the Swedish standard on auditing (RS), which auditors followed up until January 2011. Seeing that auditors review companies' financial statements we chose to include the International Accounting Standards Boards (IASB) Framework, which is a guide for establishment of financial statements. Considering our demarcation to audit of financial companies we have chosen to include an accounting standard regulating financial instruments, the International Accounting Standard (IAS) 39, seeing that financial instruments is an important area in a financial company and it is a complex matter. The different standards and regulations were found through the database "Far Komplet", which include all regulations in context of audit and accounting. Besides regulations we have included articles from the Swedish newspaper "Svenska Dagbladet" owing to the criticism towards auditors in these articles. We have included scientific articles from different auditing and accounting journals dealing with the previous Enron scandal and the S&L crisis which followed criticism towards auditors. The audit and accounting journals were found through the database

Business Source Premier. In order to find relevant articles we limited our search to certain keywords; “audit & financial crisis”, “audit, & crisis”, “audit & criticism”, “Enron & audit”, “ S&L crisis & audit” and “financial crisis”. Through our search we found a relevant theory by Hyman P. Minsky, which discussed economic conditions and behavior leading to financial crisis.

In order to conduct the interviews we chose to interview chartered auditors working with financial companies from the four biggest audit firms, seeing that the four biggest audit firms work with the biggest financial companies, and this is relevant for our study. Chartered auditors have great experience and may be more aware of changes in audit due to the financial crisis. We found the right people through the firms’ websites. In total we called 25 persons and booked seven interviews, four of the chartered auditors were from KPMG, one was from Deloitte and two were from pwc, we were not able to reach a respondent from Ernst & Young. It takes time to conduct interviews and considering our limited time frame our goal was to conduct eight interviews. A few of the calls we made were not answered and some of our emails were never replied to. Seeing that most auditors working with the financial sector are located in Stockholm we chose to go there and perform four of the seven interviews personally. The other three interviews were performed personally in Gothenburg. When gathering data it is important to understand that the choices being made will have implications for the outcome of the research. One choice is whether to make personal or telephone interviews. Telephone interviews are time efficient but the advantage of personal interviews is greater in our case through the establishment of personal contact and furthermore obtaining more precise answers and being able to interpret the respondents’ reactions (Jacobsen 2002). When we had booked our seven interviews we mailed an interview template to the respondents where we included the most important questions and had a short introduction and explanation of our study.

The interview can be executed in several ways considering our research question we performed a partially structured interview. A partially structured interview is commonly used when researchers have a certain level of knowledge of the subject, but want to obtain new aspects and angles of the problem in question (Andersen 1998). In order to perform a high-quality interview and receive answers relevant to our research question we found prior research necessary. We started our interview with basic information questions about the auditor and followed with questions about different parts in the audit process and difficulties with the standard IAS 39, Financial Instruments. In the end we had a discussion about the recent criticism towards auditors and how the auditors can be better prepared for new crises. One of the interviews we booked in an early stage of our research was with a recently employed auditor not working with financial institutes, therefore we chose to use this interview as a pilot interview and test our questions in this interview first. Therefore only six interviews will be used as empirical data on the grounds of our demarcation.

All our interviews but one was recorded. After completing each interview, which stretched from 50 to 90 minutes, we summarized all our notes, listened to the interview once more and compiled the interview with the most relevant answers according to our questions. We chose to present each interview separately in order for the readers of this study to be able to obtain an overview and evaluate the results with minimum involvement from the authors. The interviews are presented in the same order they are conducted.

We need to be aware of the difficulties with qualitative research, for instance it is difficult to draw general conclusions when conducting interviews with a small sample of respondents. The respondents’ answers are subjective and may not represent the general view in the audit business. (Jacobsen 2002)

2.3 Analysis of empirical data

The study's research question guides the interpretation and analysis of the empirical data. The analysis should narrow down data and exclude parts that are not relevant in order to be able to answer the research question (Andersen 1998). In the analysis we want to find relevant and possible changes in auditors' behavior and practical work and derive it from the financial crisis and criticism. In order to analyze we need to understand the statutory framework of audit and accounting within the financial industry. When analyzing our material we found themes in the respondents' answers that are relevant for our study. Themes we found important were either involved in the majority of the respondents' answers or relevant in the context of the theoretical framework, hence, important for the answer of our research question. The respondents' answers relevant for the different themes were compared and analyzed in the context of the theoretical framework.

2.4 Validity

Considering validity we need to be aware of the relevance in the data we collect through interviews and the relevance of the articles and statutory framework used in the research. The relevance has to be based on our own judgment because of the difficulties in measurement of relevance. (Andersen 1998) With our theoretical framework we will be able to judge the relevance and argue the validity of the empirical data collected. In the theoretical framework we are using scientific articles written in an American context. We have to consider differences in the Swedish and American audit environment. There are differences in regulations between the countries, however seeing that we do not deal with regulation issues we still find the articles relevant owing to that the articles are mainly focusing on criticism towards auditors and which effect the criticism had on the auditors' work.

2.5 Credibility

Qualitative research is vulnerable to the risk of writers' bias (Andersen 1998). We will personally collect, process and interpret the empirical data we receive through interviews. It is therefore important to be critical of the interpretations and conclusions made. We also need to ask the question of credibility of the answers given by the respondents seeing that they may as well be biased and not willing to be critical of their own work and company. Seeing that we do not have an equal distribution of our interviews between the four big audit firms it could prevent an attempt to draw a general conclusion in the audit business. However, all auditors follow a given statutory framework and should all perform accordingly, hence, they are affected similarly. Given the recent criticism towards auditors in the financial service sector they may want to present a positive image of audit. The question of the auditors' objectivity is therefore necessary.

2.6 Criticism of the sources

The theoretical framework in our study is based on legal documents and the statutory framework within accounting and audit. The need of criticizing the source is therefore not relevant. The articles concerning criticism towards auditors in Sweden is however based on articles in Swedish newspapers and is therefore not objective. Seeing that we examine the effect of the criticism from these articles they are relevant. However, we need to be aware of that the material in these articles may not be facts, and we do not use the content in the articles in order to analyze. The accounting and audit journals used in our theoretical framework are retrieved from the database, Business Source Premier.

3 Theoretical framework

Chapter 3 is a presentation of the theoretical framework given in order to understand the role and purpose of audit as well as the audit process. Latter, IASB's framework is introduced seeing that it is a guide for the preparation of financial statements, which auditors review. Furthermore, IAS 39 is presented owing to the complexity and frequent occurrence in financial companies.

3.1 The purpose of audit

Stakeholders need to be confident with trustworthiness of the financial statements. Hence, the purpose of an audit is to improve the degree of certainty in the financial statements for different stakeholders. The auditor expresses opinions on whether the financial statement is prepared in congruence with an appropriate financial legal or reporting framework and whether the financial statement is presented fairly or gives a true and fair view in accordance with the framework. (ISA 200)

When auditors are forming their opinions it is central that the auditor obtains reasonable assurance that the financial statement in large is correct and free from material misstatement. The high level of assurance, reasonable assurance, is obtained when the auditor has collected and obtained adequate information, audit evidence, sufficient to reduce the audit risk. (ISA 200) The audit risk is the risk for the auditor to make an incorrect statement and it is affected by detection risk, inherit risk, and control risk. The detection risk is the risk to not detect material misstatements and the inherit risk is the risk that may occur due to the undertaking of the business, the conditions in the business may be complex and the valuation of liabilities and assets may cause problems and hence a high inherit risk. The control risk is the risk to not detect misstatements within the internal control function. (ISA 200)

Materiality is an important concept in the audit process, both in planning and performing the audit. Misstatements are, in general, material when they are expected to influence economic decisions taken by external users, influenced by the financial statement. The auditor's opinion is on the financial statements as a whole. Hence, the auditor is not responsible for finding misstatements that are not material for the financial statement as a whole. (ISA 200)

3.2 Objectives for the auditor

The general guidelines from the International Standards on Auditing (ISA) are that the overall objectives are:

“(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.” (ISA 200)

When the auditor cannot obtain reasonable assurance and cannot give an opinion in the auditor's report that is in congruence with the purposes of reporting, the auditor shall disclaim or withdraw from the engagement. (ISA 200)

There are requirements the auditor needs to follow. The auditor shall consider the relevant ethical requirements like the requirement of being independent when controlling financial statements, plan and conduct the auditing with professional skepticism; recognizing that circumstances may exist that may lead to material misstatements, and having a professional judgment when planning and performing the audit. The auditor is responsible for the opinion on the financial statements but the management of the firm is responsible for the establishment of the financial statements. Audit of the financial statements does not relieve the management of the firm of their responsibility. (ISA 200)

3.3 Audit process

3.3.1 Planning

Planning is an important part of the audit process. The objective of the planning is to make sure the audit is done effectively. The planning should include an overall audit strategy and developing an audit plan. Good planning will help the audit of financial statements in several ways. The planning will help the auditor; to focus on the important areas of audit, to identify and solve potential problems in time, to organize the auditing in order to be efficient, and to assess the use of experts in the audit. The planning process is not a separate phase of the audit. The process starts when the last audit ended and continues until the audit is done. (ISA 300)

One important element in the planning process is materiality. Materiality determines what to focus on and to what extent the review will be conducted. When deciding materiality the auditor needs to use his or her professional judgment. During the establishment of the overall audit strategy the auditor shall estimate the materiality of the financial statements as a whole. (ISA 320) This is done in order to be sure that the review will focus on the correct areas. To understand where the material misstatements may arise the auditor needs to understand the business activities, the risk causing material misstatements, and to understand the internal control systems. (Far förlag 2006)

The auditor's objective is to identify and assess the risks of material misstatements. The auditor shall conduct a risk assessment procedure to identify and assess the risk of material misstatements in the financial statements. The risk assessment procedure is a review, performed to get an understanding of the company and its environment and shall include inquiries of the management and others in the company that may have information that is likely to identify risks of material misstatements, an analytical procedure, and observation and inspection. All businesses differ from each other and therefore it is important to have satisfactory knowledge about the business. (ISA 315)

3.3.2 Review

The auditor may choose between two different types of audit procedures or a combination between the two. The methods are tests of controls and substantive procedures. The method that is most effective in every case is selected. (Far förlag 2006)

Tests of control are the auditor's control of the company's internal control function. Most companies have established some form of internal control to make sure that the employees will do what they are supposed to. For example the internal control could prevent fraud. The auditor needs to understand how the internal control of a business is working to be able to understand the risks linked to the business. (Far förlag 2006) When understanding the internal control relevant to the audit, the auditor shall evaluate the design of the internal controls and whether the internal control has been implemented. (ISA 315) To make sure that internal control is working correctly the auditor needs to verify the internal work by different observations. The observations may include direct observations, interviews with employees, documentation studies and control function testing. (Far förlag 2006)

Another way to control the business is to perform a substantive procedure and the auditor shall do so irrespective of the assessed risks of material misstatements. Substantive procedure is done in two ways, to control balance sheet and income statement and the underlying transactions, and to conduct a substantive analytical procedure. (ISA 330)

3.3.3 Audit evidence

The auditor shall design and perform audit procedures in a way that enables the auditor to collect sufficient and appropriate audit evidence. The evidence is used to draw conclusions on the material and to base a foundation for the auditors' opinion. (ISA 500) When auditors are forming their opinion it is central that the auditors obtain reasonable assurance that the financial statement in large is correct and free from material misstatement. The high level of assurance, reasonable assurance, is obtained when the auditor has collected and obtained adequate information, audit evidence, sufficient to reduce the audit risk. The audit risk is the risk to express an incorrect opinion about a financial statement with material misstatements. (ISA 200)

The purpose of the audit procedure is to get sufficient and appropriate audit evidence. Sufficient amount of audit evidence is a measure of how much audit evidence is needed. Appropriate audit evidence is the measure of quality of the audit evidence, how relevant it is for the review and the reliability of the audit evidence. To reach both sufficiency and appropriateness, the auditors collect evidence from different sources in order to be able to support their opinion. Depending on the type of source the auditors collect their audit evidence it will affect the reliability. Audit evidence from independent external sources is more reliable than evidence from an internal source. The reliability is also affected by how the evidence is presented; evidence based on a written document is more reliable than an oral statement. When collecting audit evidence the auditor shall use his or her professional judgment to minimize the audit risk. (ISA 500)

If the auditor uses information from the company's experts as audit evidence, the auditor shall regard the expert's objectivity and competence, evaluate the appropriateness of the expert and obtain understanding of the expert's work. (ISA 500)

3.3.4 Documentation

The auditor is responsible for the establishment of documentation. The documentation shall provide evidence that the auditor have fulfilled the overall objectives of the audit. The auditor shall establish documentation that is sufficient and appropriate for the auditor's report, and establish documentation on evidence that the audit has been made in accordance with ISA and the Swedish legal framework. The documentation shall be established in a way that an experienced auditor, who is not involved in the audit process, will understand the entire audit process. (ISA 230)

3.4 Audit of estimates in accounting

Some of the items in the financial statement are being estimated due to the fact that they cannot be measured precisely, which is called accounting estimates. The nature and reliability of the information used by the management to support the accounting estimates vary widely. This will affect the degree of uncertainty in accounting, which in turn will affect the risk of material misstatements of accounting estimates. The estimations may be affected, intentionally or unintentionally, of the management's lack of objectivity. The objective of the auditor is to collect sufficient and appropriate audit evidence to be able to have an opinion on, in the context of applicable financial reporting framework, whether the accounting estimates are reasonable and whether the related disclosures are adequate. (ISA 540)

3.5 IASB framework

The International Accounting Standards Board's (IASB) framework is a guide for preparation and presentation of financial statements. It was established by IASB in April 2001. The purpose of the framework is to minimize differences in the financial statements internationally as well as improve and guide the working process of IASB to create new International accounting standards (IAS). Another important purpose is to guide auditors in their control and review of the financial statements as well as enabling them to estimate whether the financial statements are established according to IAS standards.

The financial statements are to be established with the assumption of the going concern principle, which means that the organization will continue in the long term and in the foreseeable future. The statements are to be prepared according to the accrual method, hence report transactions in the period to which they relate. The statements reported under accrual assumptions will therefore show inflow and outflow of resources as well as future obligations of in- and outflow of resources.

A financial statement is carried out by the company's management and consists of a balance sheet, income statement and a cash flow statement followed by written statements with additional information. The financial statement provides information on the company's financial situation, hence financial position, financial performance and changes in financial position. Thus it is of interest for several external users, for instance;

Investors: Interest in analyzing the risk of investing in the company as well as possible future yield. The information given in the statements will support the decision whether to buy, sell or keep shares in the company.

Lenders: The information in the statements reassures the lenders of whether the company is able to repay the loan and pay interest.

The State: The financial statement is of interest for the state in determination of taxation policies.

3.5.1 Qualitative characteristics

An important aspect of the financial statements is the qualitative characteristics. The information in the statement is important for external users, in order for them to find the information useful. The qualitative characteristics given by IASB's framework refer to understandability, relevance, reliability and comparability. All qualitative characteristics are important and shall not overrule each other. It is important for the users that the information in the financial statement is understandable. The information in the statements is considered relevant supposing that the users will find the information useful and supportive for their business decisions and risk determination of the company, as well as estimations and predictions of the company. Reliability is as well an important qualitative characteristic. Reliability implies the information not to be biased and requires the information to be presented without any substantial errors. The company is obliged to inform which accounting principles are used as well as inform of which changes have been made in order to facilitate comparison for the users.

3.5.2 Valuation methods

As mentioned above, financial statements are important for external users in order for them to evaluate the company and facilitate their business decisions. The most important part of a financial statement in order to evaluate the companies' financial position is assets, liabilities and equity. An asset is a resource with expected future economic advantages for the company, which the company

has control over and has appeared through occurred events. A liability is a present obligation followed by occurred events and implies future outflow of resources which bear an advantage for the company. Equity is the differential between assets and liabilities which is the company's net assets. Valuation of these important items implies determination of which value will be reported in the financial statement.

3.6 IAS 39 - Financial Instruments

This following section is a compiled summary of IAS 39 relevant in this study. International accounting standard (IAS) 39 is a standard dealing with reporting and valuation of financial instruments. Financial instruments include financial assets and financial liabilities and in some cases, agreements regarding purchase or sale of non-financial items are considered as financial instruments. IAS 39 is supplemented by IAS 32, which addresses the question of classification of financial instruments, and IFRS 7 which deals with the disclosure requirements of financial instruments.

Financial instruments are defined in IAS 32 and these definitions are reused in IAS 39. A financial asset or financial liability is valued at fair value by the result. The financial asset or liability is held for trading and acquired with the purpose of disposal within a short period of time or was a part of the portfolio with identifiable financial instruments when first reported. Accounts receivables intended to stay within the company for a longer period of time are financial assets. Accounts receivables are not listed on an active market and are reported with a determined payment. A derivative is a financial instrument whose value will alter due to changes in interest rate, the value of a financial instrument, exchange rate and raw material price. A derivative is regulated at a distant date. Investments held to maturity, which are not derivatives, are financial assets with determined payment and the purpose to be held to maturity.

At the first occasion a financial asset or financial liability is reported in the financial statement it shall be valued at its fair value. In the following reporting of financial assets and derivatives, they are valued at their fair value including transaction costs. Accounts receivables and investments held to maturity are by using effective interest methods valued at accrued purchase value. Financial liabilities are as well valued at accrued purchase value by using the effective interest method.

The most reliable fair value is listed on an active market. In cases where an active market for the financial instrument does not exist, the company uses valuation techniques in order to determine the fair value. By using a valuation technique the company can determine the fair value and price of the financial instrument through determining what the price would have been at the valuation time for a transaction between two independent knowledgeable partners with interest in carrying out the transaction. The valuation techniques are based on recently performed transactions together with an analysis of discounted cash flows and option pricing models and thereafter applied to similar financial instruments. In cases where a valuation technique is commonly used on the market in order to set a price on an instrument, and these techniques have proven to show reliable prices which can be obtained in real markets, this technique will be used by the company. Valuation techniques use, as high degree as possible of market information in order to find the right fair value.

A company is allowed reclassification of financial assets from financial assets and liabilities valued at fair value by the result under exceptional circumstances, if the purpose is no longer to sell the asset and the company has the ability to retain the financial asset in the long term. A financial instrument which was classified at its fair value by the result originally, cannot be reclassified. A derivative cannot be reclassified from financial assets and liabilities valued at fair value by the result while it is in the company's possession.

4 Criticism towards auditors

This chapter presents one theory dealing with financial crisis and previous examples on cases where auditors have received criticism, followed by the recent criticism towards auditors in Sweden.

4.1 State of economic euphoria

Minsky (1982) presents a theory dealing with behavior leading to a recession. The economy experience cyclical movements throughout its history. When the economy is in a state of high financial stability the financial system is strong. Given the time of financial stability both companies and banks are getting used to the strong economic state and memories of past recessions and crises are starting to fade. Thoughts about future prosperity and growth dominate, which alter the managements' mindset. The demand for investments increases seeing the expectations on future profit and growth rate. According to the theory of Minsky (1982), this will lead to a state of economic euphoria. The increase in investments will lead to decrease in liquidity and higher interest rates, this will alter the stable economy into a highly unstable situation which is vulnerable to changing conditions in the financial markets. The increasing interest rates affect the profits negatively, which will be the start of doubting the prosperity in the economy. If the financial situation and doubts cannot be prevented, the economic euphoria will end in a financial crisis. (Leathers & Raines 2008)

Several examples can be found of recessions, different types of financial crises and big companies going into bankruptcy, and how these examples are affecting the rest of the economy. In some of these cases, auditors have received criticism and negative focus in the media, much like the criticism towards auditors in Sweden now. The S&L crisis in the U.S in the late 1980's and Enron's bankruptcy are only two examples of disturbance in the financial system, which was followed by criticism towards auditors.

4.2 S&L Crisis and the effect on auditors

Savings and Loans are specialized banks using low interest rate. In the late 1980's a savings- and loan crisis hit the U.S. The crisis was caused by increasing interest costs which exceeded the low interest rate income, regulators therefore decided to allow S&L to expand into new, riskier areas; commercial real estate and consumer loans. A drop in oil- and real estate prices followed with insecure loans, but in hope of economic improvements S&L continued to operate.(AICPA President 1989) In the context of the S&L crisis the audit profession was receiving a great deal of negative attention in the media and criticism from the General Accounting Office (GAO) 1988. A report from GAO states that the auditors failed to retrieve independent verifications, perform a correct risk assessment and their biggest deficiency was considered to be that they did not perform audit on a timely basis. (Nelson 1990) The audit mistakes presented in the report were based on 11 audits of S&Ls where 6 of them did not audit and report the S&Ls according to their statutory framework at the time of the crisis in the U.S. (AICPA President 1989)

The importance of an auditor's good reputation as well as how quickly a scandal could destroy the audit's reputation was highlighted after the S&L crisis and the issue of public expectations on auditors to foresee the crisis and warn the financial market and the public was stresses. After the crisis it was emphasized that the expectations were too high and the idea of auditors as "cure-all" were incorrect, the expectation gap needed to become smaller. (Nelson 1990)

4.3 The fall of Enron and the effect on auditors

Enron was rated the most innovative company in the United States in 2000, with a fast increase in its stock over several years and high expectations about future prospects. It was not expected that the company would apply for bankruptcy within a year. Enron was founded in 1985 through a merger of two natural gas pipeline companies in 1985 and diversified later into natural gas trading and other markets which led to Enron getting involved in the financial market through financial trading. Enron's complex business model which included varieties of products, physical assets and trading operations internationally was testing the limits of accounting and portrayed a better image of its performance. Several accounting problems were detected in their financial reporting and the question of how the problems could go on undetected was challenged. Enron's auditors, working at the former audit company Arthur Andersen, were blamed in this controversial example of accounting problems. The auditors failed to judge Enron's financial statement, whether it was due to lack in expertise or due to financial incentives to keep Enron as their client. (Healy & Krishna 2003)

The fall of Enron and the failings of the audit affected the whole audit profession negatively, the investors started doubting the reliability of auditors' reports and the profession was looked upon as unattractive. The whole belief system in financial auditing was questioned. (Healy, Krishna 2003) The auditor's independence was as well challenged after the Enron scandal seeing that the relationship between the auditor and their clients Enron was thought upon as biased through Enron's influence on the auditors. It is important for the financial system that belief in the audit performed is maintained since the quality of the audit cannot be reviewed by external users of the financial statements themselves. The judgment on the value and reliability of audit is therefore based on the reputation of auditors. Thus, a scandal of Enron's sort does bring harm to the audit profession as well as the financial system. (Krishna, Saravanan & Seetharaman 2010)

After the Enron scandal and the fall of the audit company Arthur Andersen the audit business needed to reinforce their reputation, therefore several measures were taken and discussed. Measures were needed in order for audit to return to its former position of respect and trust. Besides alterations in the American accounting regulation, the need for change in the expectation gap between the auditors and the public was discussed. The auditor's responsibility and role needs to be consistent with public expectations and therefore the auditors' role need to be clearly explained (Krishna, Saravanan & Seetharaman 2010). Studies have been done to research auditors' behavior after the period of Enron's bankruptcy and the results showed that auditors do behave more conservatively when mentioned in the media spotlight with a decreasing effect over time (Feldmann & Read 2010).

4.4 Criticism towards auditors in a Swedish context

The Swedish Financial Supervisory Authority's role is to make sure there is an efficient and stable financial market in Sweden. (Finansinspektionen 2011) During the fall of 2010 FI criticized the auditor of HQ bank. The auditor received harsh criticism and FI reported him to the Supervisory Board of Public Accountants (RN). The Swedish Financial Supervisory Authority's (FI) view was that the auditor conducted the audit with "lack of integrity". (Almgren 2010) Later in the fall of 2010 harsh criticism was directed towards the Swedish audit industry in the Swedish daily newspaper "Svenska Dagbladet" (SvD). In several articles, the high salaries of auditors was examined and criticized as well as the fact that an audit firm could conduct audit at the same time that they sold consulting services to the same company. The independence of the auditors was questioned. (Brusell & Neurath 2010a, 2010b, 2010c)

The criticism in SvD from FI led to a meeting between the Swedish Minister of Financial Markets, Peter Norman, and the four chairmen of the big audit firms. The meeting was according to the

newspaper stressed by Peter Norman who was worried that there were problems with the quality in the audit industry. Peter Norman claims that the audit is important for the financial market and therefore it is important to have a high degree of confidence in the audit industry. (Brusell & Neurath 2010d)

5 Results

Chapter 5 presents the result of the empirical data collected. The six interviews are presented separately in order for the reader to be able to obtain an overview. The questions presented in this chapter are based on the theoretical framework in chapter 3.

5.1 Respondent 1 – KPMG

The first interview was performed with Respondent 1, a chartered auditor at KPMG. Respondent 1 has worked as an auditor for 36 years with a lot of different industries and companies. Today his main business areas are shipping and finance.

Does the audit process differ for financial service companies and has the process been altered due to the financial crisis?

When reviewing a financial industry's financial statement, the risk assessment and internal control is taken more into consideration compared to other industries due to the high risk within the financial sector and the difficult valuation aspect. In order to conduct audit on financial companies you need to have experience from working with financial industries. The audit process itself has not altered due to the financial crisis, but the importance of different parts has changed. The valuation of financial instruments is a significant question that receives a lot of focus in audit. Due to the complexity with the financial instrument standard, the demand for accounting experts has increased. They are competent within a certain area and assist the auditor with complex valuation questions. Accounting experts have always been used within audit, but Respondent 1 perceives there to be a higher demand for them today. He does not have an opinion whether it is connected with the recent financial crisis or the regulations in the standards that follow a higher degree of complexity. An obligation for the auditors stressed by the Swedish Financial Supervisory Authority (FI) is a higher degree of documentation during the review process and greater focus on the financial industries internal control.

What audit evidence do you retrieve and do you have higher requirements on reliability for the audit evidence due to the financial crisis?

The risk assessment affects the retrieval of audit evidence. An external counterpart's confirmation considering for instance an agreement is important audit evidence. It has always been important with high sufficient reliability and this has not changed, but given the increased importance of the internal control in financial industries, audit evidence in the context of internal control is important. It is of greater importance today to give information about the audit evidence and the retrieving process.

Which material misstatements were found to be the greatest problem area during the financial crisis and how is it today? Have alterations been made in order to reduce material misstatements?

Respondent 1 states that the company he reviews has few material misstatements that are detected. Given the long lasting relation with his client, discussion arises when the problems occur. A complex problem area resulting in discussion today as well as during the financial crisis is valuation of financial instruments when the instruments are not listed on an active market, another area is interpretation of accounting standards. In his opinion valuation of financial instruments at fair value is considered more a probability theory. In order to improve and simplify the process of dealing with the valuation aspect the assistance of accounting experts is necessary as well as focusing on planning and risk assessment in order to decrease material misstatements.

Considering the difficulties in practicing IAS 39, financial instruments, how has this affected audit?

The difficulties of practicing IAS 39 stresses the importance of collaboration with accounting experts, and preferably using first- and second opinions in the matters considering valuation, in order to give quality assurance to auditors. The difficulties follow greater importance of documentation for the auditor, information needs to be given for all the work and the method of working. There are higher requirements on competence today in order to work with financial instruments, both from the professional institute for auditors, FAR, but mostly from the audit company. A greater variety of education is now available in order to increase competence within this area. In the future auditors will need to limit their area of expertise and specialize in financial industries to be able to review their financial statements.

Which areas in the financial statements do you focus mostly on today?

When working with financial industries the valuation aspect is and has been since the introduction of fair value, an important issue which auditors and the companies involved stress and add resources to. This area has received more attention since the financial crisis.

Have alterations in your companies' policy been made owing to the financial crisis?

Respondent 1, working at KPMG states that there has been an increase in the internal information given. The information is today more focused and directed to certain areas which make the information more useful. The requirements on quality assurance are as well increasing.

How are you better prepared for a new crisis following the changes that has been made?

With the new requirements for financial industries considering consolidation the risk of financial collapse is small for the Swedish banks. Apart from the changes in regulations, a discussion about measures in audit between the four big audit companies and the Swedish minister for financial markets is ongoing. This discussion was raised due to the recent criticism towards auditors and their audit of financial service industries.

Considering the recent criticism towards audit and auditors, are you concerned that a decrease in confidence will follow?

The criticism has affected the audit business negatively, but it is necessary to be aware that the media is always putting a certain angle on the story, and auditors have chosen not to take part in the debate. The criticism has affected auditors and they are more observant when it comes to risks concerning valuation and do use accounting experts more frequently. As an auditor you don't want to take any unnecessary risks.

5.2 Respondent 2 – KPMG

The second interview was conducted with a chartered auditor that has been an auditor for 30 years. Respondent 2 has great experience with financial service companies and is today auditor for one of the leading banks in Sweden.

Does the audit process differ for financial service companies and has the process been altered due to the financial crisis?

Overall the audit process has not been changed, it is the same key issues when conducting a review of financial companies. 80 percent of what the auditor does is still the same since the issues within a financial company are generic; who will be able to borrow and trade with derivatives. The risks linked to the bank business are the same and therefore the audit process has not experienced any drastic

changes. However, the valuation issues are of greater concern today, the auditors are more likely to thoroughly control whether assets are valued correctly.

The media, closer control from authorities together with a harder regulatory system has also affected the audit process. Today you will have problem with authorities even if the company is going well but the company has broken a rule. The requirements for documentation are higher today.

What audit evidence do you retrieve and do you have higher requirements on reliability for the audit evidence due to the financial crisis?

There are no higher requirements on the audit evidence through changes in the process or regulations, but due to the “baggage” and the awareness of the crisis an auditor is more careful and consistent when collecting audit evidence. Respondent 2 states that auditors are more observant and require more documentation for what has happened. The review of a company’s internal control has received more attention.

Which material misstatements were found to be the greatest problem area during the financial crisis and how is it today? Have alterations been made in order to reduce material misstatements?

A common material misstatement was valuation of financial instruments. When dealing with valuation at market value and fair value, hence, what the asset is worth “right now” it requires more understanding and analyses when dealing with valuation issues in the financial statements. The valuation issue is dealing with the present and not the future, and the valuation method is insecure. This has contributed to volatility. The high volatility does not always mean that the valuation has been done incorrectly; it could be due to great fluctuations in the market. The valuation could be wrong due to a mistake in a business transaction that has contributed to a decrease in the company’s value, or due to a mistake in the analysis which would imply that the valuation is not established according to a standard.

A change that has occurred and escalated due to the financial crisis is the increase in the disclosure requirements in the financial statements which companies establish. This so the analysts can understand and evaluate whether the assets are valued correct and according to fair value.

Considering the difficulties in practicing IAS 39, financial instruments, how has this affected audit?

IAS 39 and IFRS 7 are more precise but it is more difficult to handle and practice. It was a long process for both companies and auditors to learn how to apply it.

Which areas in the financial statements do you focus mostly on today?

Respondent 2 states that the focus is overall more on risk assessment, different types of valuation models and counterparty risk.

Have alterations in your company’s policy been made owing to the financial crisis?

Respondent 2, working at KPMG says they have carried out more seminars with the clients. Auditors also need to have an accounting expert involved when working with IFRS. There has also been an increasing formalization and more documentation requirements.

How are you better prepared for a new crisis following the changes that has been made?

It is difficult to prepare for something you do not know will happen. One of the reasons that the Swedish banks made it better through this crisis than the crisis in the beginning of the 90’s, is due to the fact that the banks’ board members had experience of the crisis in the 90’s. The ones that have experienced a crisis are more aware of the risk of a new crisis. The financial system is generally better

prepared today for a new crisis than three years ago. If times are good and everything is going well it will make you more relaxed. When a crisis hits the economy you will become more alert.

The people who have experienced the crisis have different perspectives today and are more aware of the link between financial companies and the economy and the state. As an auditor you understand that you have an important responsibility and that the role of the auditor is important due to the recent focus on financial companies. The ones that have experienced this last crisis are more aware of the risk of a new crisis.

“Imagine if you are driving a car and suddenly you are near a collision. When you have been near a collision you will be more alert the next 45 minutes. The same applies to the financial sector. They have been very close to several collisions. We have tried the airbags and other security systems. Some of the systems have proved to be working but others need to be changed.”

This crisis was a huge stress test for the financial market. The mindset of the people working in the audit business has changed, there have happened so many unthinkable things in a short period of time, and therefore we have started to realize that unthinkable things can happen. We are better prepared to handle the risk issues.

Considering the recent criticism and the crisis in the financial market, a meeting was held with the Swedish minister of financial markets, Peter Norman and the chairmen of the four big audit firms. Peter Norman’s message to the audit industry is: it is crucial that the financial market is functioning properly, therefore the auditors are important in their role to make sure the financial market is working. The government cannot compensate when the auditor does not live up to the requirements. During the meeting several actions in order to improve audit were considered. One issue discussed was the lack of cooperation and communication between FI and the auditors, which needs to be improved. Both FI and the audit business have similar purposes when it comes to the financial market and therefore they should communicate and exchange experiences. Another issue discussed was the standards for the financial industry. Because of its importance the audit should be done with the highest possible standard. For the listed companies there is a set of different rules for audit, this should apply for financial companies as well. A third issue and action discussed was the review process. The main assignment for an auditor is to have an opinion on whether the financial statement is correct or not. This can be reviewed in two ways, substantive procedure or internal control. The auditors have always been choosing the one they consider the most efficient. Now the internal control should always be used due to the fact that it is considered to be important in the financial companies.

Considering the recent criticism towards audit and auditors, are you concerned that a decrease in confidence will follow?

Respondent 2 distinguished between two groups, the public and the professionals. The professional part will probably not be affected. They are quite hardened due to experience. The public view of the audit may have been affected. The requirements on the auditors’ work from the public are big. The public does not tolerate mistakes from auditors. If the expectations are that an auditor never will make a mistake they will eventually fail.

5.3 Respondent 3 – Deloitte

Our third interview was performed with Respondent 3, a chartered auditor at Deloitte. Respondent 3 has worked as an auditor for 25 years, mostly with financial companies.

Does the audit process differ for financial service companies and has the process been altered due to the financial crisis?

In theory an audit process is the same for all industries, but in practice it can differ due to the risk assessment and the importance of internal control. Financial companies are as well monitored by the Swedish Financial Supervisory Authority (FI) and audit of management is more significant. The answer to the question of change in the audit process due to the financial crisis should be no, but it does influence the auditors review of financial statements. An auditor does become more observant and accurate when reviewing the areas that have been a problem area during the crisis. Liquidity shortage and valuation of financial instruments where an active market does not exist were problem areas which got attention in the crisis and therefore still receive attention when reviewed. However, the audit process itself has not been altered.

What audit evidence do you retrieve and do you have higher requirements on reliability for the audit evidence due to the financial crisis?

Audit evidence is to be sufficiently strong for the existing risks when it comes to all companies. However, it has become more important to gather evidence from experts such as lawyers and accounting experts as well as second opinions. The retrieval of audit evidence should be the same and not depended on fluctuations in the economy, but in a recession auditors question whether the work is sufficient and more resources and time is spent on the retrieval. The surrounding world is continuously changing and therefore the work changes as well.

Which material misstatements were found to be the greatest problem area during the financial crisis and how is it today? Have alterations been made in order to reduce material misstatements?

The financial crisis had its origin in liquidity shortage that led to distrust in the financial market. This resulted in the banks not lending out money to each other. The consequence of lack of confidence in the financial market led to more regulations from authorities. Another problem was the valuation of financial instruments at fair value, therefore Respondent 3 thinks there should have been more focus on this area. A material misstatement becomes more drastic during a recession considering the decrease in results and smaller buffers. In theory no alterations have been made, but considering higher requirements and regulations from authorities auditors are more accurate and skeptical when reviewing financial statements.

Considering the difficulties in practicing IAS 39, financial instruments, how has this affected audit?

When a financial instrument does not exist on an active market it is difficult to value it at its fair value. For auditors this has meant a higher demand for accounting experts, even if they were important before the crisis as well. Change in regulations or economic situations always entail an increase in consulting hours, it is costly but necessary.

Which areas in the financial statements do you focus mostly on today?

Risk assessment varies between the different states of the economy. In the recession the risks are higher and liquidity, financial instruments, credit losses and goodwill received more attention. In today's economy the banks are stable in Sweden. However, after the financial crisis we have learned the significance of the interaction globally and the Swedish banks need to be aware of problems in other EU countries, for instance the PIGS countries. A crisis there may as well affect the Swedish economy once more. Therefore the focus is still great on the problem areas from the crisis.

Have alterations in your companies' policy been made owing to the financial crisis?

Respondent 3 claims that his audit firm always has had a continuous education of their employees. During a recession the management of an audit company have a change in their mindset through attempts in avoiding costs, at the same time they are aware of the increase in time and resources

needed, considering higher risks in recession, in order to be able to perform an appropriate and sufficient audit.

How are you better prepared for a new crisis following the changes that has been made?

Respondent 3 believes that experience and knowledge will always prepare you better for the future. However, preparing for the unknown is not realistic. Even so, to plan and prepare is necessary even if the plan itself will be of no use. Therefore it is important for the auditors to have a wide industry expertise and practice a close monitoring of the companies they review.

Considering the recent criticism towards audit and auditors, are you concerned that a decrease in confidence will follow?

The negative criticism and focus is not good for the audit business but auditors have not experienced lack of confidence from their clients. One aspect of concern is how the negative focus on auditors will affect the students. Respondent 3 thinks the foundation of the criticism lies in the expectation gap between audit and the public. The public are not always informed about the work of an auditor and have therefore incorrect expectations. An aspect to be considered is whether to convey an auditors' role better or change the role and purpose of an auditor in the future.

5.4 Respondent 4 – pwc

Respondent 4 is a chartered auditor and has been working in the business for 15 years. He is involved in the audit of financial companies.

Does the audit process differ for financial service companies and has the process been altered due to the financial crisis?

Respondent 4 claims that there are differences in the audit process for financial companies compared to others. However, according to the standards there shall not be differences in the audit process but Respondent 4 states that there are differences in what an auditor does and the auditor must consider the special details in a financial company. In a financial company there are more rules and regulations that affect the audit. The auditor has a responsibility to report to FI, which does not occur in other companies and this affects the audit process. Financial companies are complex and therefore the audit becomes more extensive.

Respondent 4 claims that the process has not been changed due to the financial crisis but there are questions that have been particularly relevant during and after the crisis. Two areas that have been discussed are the valuation and funding issues. These questions are of greater concern today. When it is difficult to value and when there are problems in financing the business the going concern principle is important for both the company's management and the auditors.

The valuation of financial instruments has always been important but Respondent 4 claims that among auditors the awareness of the complexity has increased and they may put more resources in the planning stage of the process to overcome the problems with valuation. Respondent 4 thinks that accounting experts may be more common today. Their services were frequently used before the financial crisis but are probably more used today. It could be very difficult to understand the valuation models used and the auditor needs help from specialists.

What audit evidence do you retrieve and do you have higher requirements on reliability for the audit evidence due to the financial crisis?

When conducting an audit in a financial company there is complexity when retrieving evidence on financial instruments. In a perfect world there is an active market for the financial instruments and then it is easy to retrieve evidence.

In other areas the auditor cannot rely on an active market and valuation based on subjectivity needs to be done. With a higher degree of subjectivity, it requires more of the auditor in order to gain a well-founded opinion.

With the increasing globalization there have been some effects on documentation. Today there are higher requirements on how much the auditor needs to document. This could be an effect from a change in culture. Business partners today are not as familiar with each other and therefore documentation is more extensive today. The auditors are affected by the development and the requirements on objectivity and reliability are higher today. Respondent 4 does not think that the higher requirements on documentation in audit are shifting focus from the important review to “paper work”. Respondent 4 thinks there are some advantages with more and longer documentation, when writing short it is difficult to be precise.

Which material misstatements were found to be the greatest problem area during the financial crisis and how is it today? Have alterations been made in order to reduce material misstatements?

Respondent 4 thinks that it is difficult to draw any general conclusion about areas in which there were material misstatements during the financial crisis. The tests of internal control functions are very important. The number of transactions in a financial company is incredibly large and therefore you will need to look behind the figures. The auditor spends significantly more time on understanding and testing the internal control than on examining the figures. Although the auditor does not test all internal control functions, the focus is on the important aspects. This is how the auditors are working today but Respondent 4 thinks that this may be changing.

According to Respondent 4, Peter Norman and FI are not interested in the audit of financial statements, they are more forward-looking. They want the auditors to focus on how the company is determining the risk of the company and what the risk areas are. Respondent 4 thinks that this is much to ask from the auditors. If the board has a problem assessing the risks, how will auditors’ manage to do it? The focus on tests of internal control will probably increase in the near future and the auditors will probably focus on other parts of the tests of internal control than today.

Considering the difficulties in practicing IAS 39, financial instruments, how has this affected audit?

Respondent 4 says that difficulties to practice IAS 39 have affected the audit. The complexity has increased due to a more global market and complex instruments. One explanation of the financial crisis is the nearly linked to global economies.

Which areas in the financial statements do you focus mostly on today?

Respondent 4 thinks that the auditor will have to be more aware of the surrounding environment. When the auditor is valuating financial instruments where an active market does not exist, the auditor will have to search for information internationally to make sure that your own interpretation of the IFRS is consistent with that of others.

Have alterations in your companies’ policy been made owing to the financial crisis?

The respondent claims that their company spends the same resources on education; he says that they have always invested much in education. The problem today is not the lack of education. The

problem is the amount of information. The information reaches the auditor through many different channels and it is difficult for the auditor to know what to focus on. The most difficult task is to understand what is relevant.

How are you better prepared for a new crisis following the changes that has been made?

Respondent 4 says that all businesses, not only the audit industry, have learned from the Swedish crisis in the 90's. There are many people who were present in the 90's that are still working today and this led to an advantage for the Swedish economy in this crisis. When you have experienced a crisis like this you will be more careful in the future. Respondent 4 thinks this recent crisis will affect people and auditors in the same way as the crisis in the 90's. People will understand that big crises may arise and this knowledge will have an impact in the future.

Considering the recent criticism towards audit and auditors, are you concerned that a decrease in confidence will follow?

Respondent 4 thinks that there is not lower confidence in auditors and their work. A decrease in confidence cannot be linked to the whole audit industry but there may be lack of confidence in individual auditors.

5.5 Respondent 5 – pwc

Respondent 5 has been working as a chartered auditor for twenty years and the last ten years only with financial companies. The respondent is both working in pwc but also in the professional institute for auditors, FAR.

Does the audit process differ for financial service companies and has the process been altered due to the financial crisis?

If the auditor has a strict view on the audit process there should not be any differences between financial companies and other industries according to the audit standards. In the future the audit process may be different between different industries. Respondent 5 thinks that the recent criticism, rather than the financial crisis has affected the requirements on financial companies, and currently auditors are working with issues considering financial companies. Today the requirements are the same for financial and other companies but the expectations are not the same considering the high risks within the financial industry.

Respondent 5 does not know if the financial crisis has affected the audit process. The crisis has initiated some changes, for instance the green paper from the European commission and other new regulations, but auditors are developing the audit process all the time and so it is difficult to tell whether the changes are due to the financial crisis or the ordinary developing process. The audit process gets more and more influenced by an international perspective. In Sweden the audit process is less extensive compared to other countries where they spend more hours on the review. It is possible that the auditors will increase their audit time in order for the work in different countries to become more similar.

What audit evidence do you retrieve and do you have higher requirements on reliability for the audit evidence due to the financial crisis?

Respondent 5 believes that it is impossible to say whether changes in the way auditors collect audit evidence are due to the financial crisis. The auditors may question the evidence more now but this could be an effect of the overall development of the society. FI's sanctions have probably a greater effect than the financial crisis, FI's requirements affect what the auditors focus on. However, FI has

great expectations on the auditors' work which is not always realistic considering the auditors' work and purpose.

Which material misstatements were found to be the greatest problem area during the financial crisis and how is it today? Have alterations been made in order to reduce material misstatements?

Respondent 5 thinks it is difficult to draw any general conclusions, but says that when people have to learn new standards there is always a great risk for material misstatements. Eventually the companies and auditors learn how they are supposed to do and they will improve their work every year. In order to facilitate the learning progress the industries use assistants from accounting experts. Respondent 5 cannot tell whether there have been any changes in how they use accounting experts, they have always been involved in the process and Respondent 5 does not think that the experts are more involved now.

Considering the difficulties in practicing IAS 39, financial instruments, how has this affected audit?

The impact on the auditor's work given the difficulty with valuation of financial instruments is that the auditors need to have knowledge and experience from IAS 39 and IFRS 7 in order to work with these standards.

Which areas in the financial statements do you focus mostly on today?

When Respondent 5 is in charge of the audit she will specially examine what kind of accounting principles the company is using and how they apply them in their business. The focus on financial instruments and on how the company chooses to value their financial instruments is important.

Have alterations in your companies' policy been made owing to the financial crisis?

There are no general policies in Respondent 5's company. They do not have policies but they have standards for auditing which have not changed.

How are you better prepared for a new crisis following the changes that has been made?

Fair value has sometimes created damages and complicates the work for auditors. Liquidity shortage is difficult for both the auditor and the banks. The financial crisis itself has not affected the auditor, it is rather the penalty cases that have occurred recently that have affected the auditor. The crisis did not hit the Swedish economy enough to have an impact on the work of an auditor. However, the crisis in the Baltic countries was close to becoming a big bank crisis in Sweden. If the respondent were an auditor in a bank that had business in the Baltic countries she would definitely be more careful and therefore consider the danger of a new crisis.

Considering the recent criticism towards audit and auditors, are you concerned that a decrease in confidence will follow?

Respondent 5 thinks that the criticism has affected the confidence in the work of an auditor. The expectations of what an auditor is doing do not match what actually happens in audit. This problem is of great concern for auditors and the question is what they should do about the problem? Respondent 5 says that the auditors can either change the expectations by increasing information about audit or change what auditors do. The respondent thinks that the solution to the problem is to meet half way, but indications from the development of auditing shows that it will be the audit that needs to be changed.

5.6 Respondent 6 – KPMG

Our final interview was with Respondent 6, a chartered auditor working at KPMG. He has been an auditor for 23 years and is currently mostly working with manufacturing companies but does have experience from financial industries as well.

Does the audit process differ for financial service companies and has the process been altered due to the financial crisis?

The audit process is founded on risk assessment. Therefore the process differs for financial service companies due to the higher risk in the financial market. The financial industry deals with bigger figures, faster turnover, more complex financial instruments and faster fluctuations. The Swedish Financial Supervisory Authority (FI) is stressing the issue of change in the audit process for the financial industry, and the discussion is ongoing between FI and the professional institute for auditors (FAR). Even though no change in regulation is decided yet, the auditors are more concerned for the quality of their review due to the recent criticism.

What audit evidence do you retrieve and do you have higher requirements on reliability for the audit evidence due to the financial crisis?

The audit evidence retrieved depends on the company an auditor reviews and the risk assessment within the company. External evidence is important evidence and if this does not exist other evidence must be retrieved and an auditor may have to redo calculations or compensate external evidence of high quality with a larger quantity of evidence. The type of audit evidence varies from case to case. Respondent 6 does not believe the audit evidence has altered due to the financial crisis, but considering higher risk during the crisis the demand for evidence may have increased.

Which material misstatements were found to be the greatest problem area during the financial crisis and how is it today? Have alterations been made in order to reduce material misstatements?

The valuation of financial instruments to its fair value was a problem area during the financial crisis. Valuing or reviewing valued securities and derivatives when trade on the market stopped and the instruments lost their value, was a difficulty. Due to this IASB quickly changed the standard for financial instruments and banks were allowed to reclassify the instruments. Another change due to this problem was the increased demand for accounting experts, but Respondent 6 believes the difficulties rather than the financial crisis increased the demand. The issue of valuation is still stressed and the focus today is on the valuation techniques the company uses. The requirements for information are greater and within the audit business the requirements for the audits are to use accounting experts more frequently.

Considering the difficulties in practicing IAS 39, financial instruments, how has this affected audit?

It is more challenging work today with higher demands and requirements from authorities as well as less tolerance for mistakes. The statutory framework is getting bigger every year and the regulations more complicated, this leaves a smaller opportunity to interpret the regulations and in the long run Respondent 6 believes it will improve the quality.

Which areas in the financial statements do you focus mostly on today?

The issue of valuation still receives great focus, apart from valuation at fair value, risk assessment and focus on internal control are important as well. An ongoing discussion between the Swedish minister of financial markets and the chairmen from the four big audit companies, concerns mandatory internal control of financial companies.

Have alterations in your companies' policy been made owing to the financial crisis?

There has been a greater focus on internal communication in order to discover mistakes and risks easier. The use of accounting experts is as well much stricter now as well as more frequent seminars and greater internal information. Auditors are today more specialized in certain areas. The focus always shifts depending on the state of the economy and change in the risks.

How are you better prepared for a new crisis following the changes that has been made?

Given that auditors are more specialized, Respondent 6 believes mistakes in the company's financial statement can more easily be discovered. Experience from crises does prepare you better for a new crisis, but sadly it is easy to forget what you have learned and repeat mistakes. Besides changes in audit the changes in regulations will prepare the financial market better for a new crisis.

Considering the recent criticism towards audit and auditors, are you concerned that a decrease in confidence will follow?

Respondent 6 states that a new study performed by FAR showed that confidence in the auditors has not decreased and not all the professionals have noticed the criticism and already have high confidence in the auditors. However, the criticism is not positive either and it does affect the auditors. In the long run the criticism may improve the communication between auditors and FI and measurements can be taken to improve the audit business.

6 Analysis

In this chapter, the results from chapter 5 will be compared and analyzed in context of the theoretical framework in chapter 3 and the articles and theory in chapter 4. The analysis builds a foundation for the conclusion made in chapter 7.

6.1 Risk assessment

According to ISA 200 an overall objective is to obtain reasonable assurance of whether the financial statements as a whole are free from material misstatements. The auditor shall conduct a risk assessment procedure to identify and assess risks in the financial statements. ISA does not differentiate the process of auditing in a financial company compared to non-financial companies. The auditors interviewed claim that according to the standards there are not supposed to be any differences in the audit process. However, four of the six respondents believe that there are differences in reality. The big differences are how the risk assessment is conducted and the importance of it, as well as the complexity with financial companies. Therefore a different risk assessment procedure is necessary. Respondent 4 claims that there are differences, but these due to more rules and regulations within a financial company as well as the auditor's responsibility to report to the Swedish Financial Supervisory Authority (FI). Although ISA does not separate financial companies from non-financial companies the standard sets high requirements on auditors to be aware of the business environment and to use their professional judgment and skepticism when performing a risk assessment. The need for additional focus of risk assessments in financial companies stated by the respondents is in congruence with the ISA.

6.2 Audit evidence

One of the objectives with the audit process is to retrieve sufficient and appropriate audit evidence and minimize the audit risk. The respondents have different opinions as to whether the requirements or the way auditors collect and analyze audit evidence have changed since the crisis. Respondents 1, 2 and 3 claim that changes may have occurred. Respondent 1 says that it is more important with the internal control today and therefore audit evidence of an internal context is of greater importance today. Respondent 2 claims that there are no higher requirements on audit evidence but there is a change in auditors' awareness and they may be more careful and consistent when collecting evidence due to the experience of the financial crisis. Respondent 3 says that there shall not be any differences in how the auditor collects and analyzes evidence in a fluctuating economy, but when you are in a recession auditors question whether the evidence is sufficient and therefore more resources will be spent on audit evidence.

Respondents 4, 5 and 6 do not think there have been any changes in the way auditors' collect evidences due to the financial crisis. Respondent 5 says that the auditors may question the audit evidence more now but she thinks it is impossible to say whether this is due to the financial crisis. She thinks the change is more closely connected with sanctions from FI than the financial crisis. Respondent 6 does not believe the audit evidence has been altered due to the financial crisis. But considering the higher risk during the crisis the demand for evidence may have increased.

There are some disagreements whether changes in audit evidence has occurred. Considering the answers it is difficult to draw a conclusion if the retrieval of audit evidence has been altered and whether it is due to the financial crisis. However, the alterations in the retrieval of audit evidence discussed are derived from the high risk in a recession, FI's sanctions and auditors' awareness after

the crisis. This implies that audit evidence may have changed due to the financial crisis and criticism in order to reduce audit risk.

6.3 Material misstatements

To understand where the material misstatements may arise the auditor needs to focus on several aspects of the company. ISA 540 states that the estimations made in the financial statement can be affected by the managements' lack of objectivity. Therefore the need of professional skepticism by the auditor is needed. The respondents say that the valuation of financial instruments at fair value without an active market is a difficult area which caused material misstatements. Respondent 3 mentions, besides financial instruments, liquidity shortage to be a problem area during the crisis which still receives focus today as well as credit losses and goodwill. The material misstatements that occurred in the financial crisis still receive focus in the audit process. Besides valuation of financial instruments, which will latter be discussed, the remaining problem areas from the crisis mentioned by Respondent 3, implies a change in which material misstatements the auditor focus on.

6.4 Tests of internal control

Pursuant to ISA 315 the tests of internal control is important in the audit process and according to the results in our study the internal control is of greater importance in financial companies. Respondents 1 and 2 agree with Respondent 4, who thinks that the importance of the internal control is due to the risk assessment connected with financial companies and due to the amount of transactions which makes it impossible to control every single transaction. The respondents claim that the tests of internal control will be more important in the near future. The increasing focus on internal control is according to the respondents a consequence of Peter Norman and FI's interest in the audit industry. According to Respondent 4 the auditors limit their focus to the material in the internal control. However, auditors will have to broaden their focus when testing internal control in financial companies in the future. Respondent 2 shares that an ongoing discussion between the Swedish minister of financial markets and the chairmen from the four big audit companies is discussing mandatory tests of internal control in financial companies. Besides improvement of communication and greater focus on internal control they have discussed the audit process for financial companies and that it should be performed similar to listed companies which follow other regulations and rules for audit. The respondents agree that they focus more on internal control when reviewing financial companies and this focus will increase in the future and have an impact. Time will tell how the changes in internal control will affect the auditors' practical work.

6.5 Financial instruments

Different financial instruments can be found in several companies but are especially prevalent within financial companies. In order for external users to evaluate the financial statements and recognize the company's financial position and performance they especially examine the company's assets, liabilities and equity. Therefore it is important for these items to be valuated correctly and with the right valuation method, according to IASB's framework. IFRS 7 deals with the disclosure requirements of financial instruments and Respondent 2 states that the disclosure requirements have increased due to the financial crisis for companies establishing financial statements. Respondent 1 states that the complexity of financial instruments' valuation has expanded the education arrangements for auditors in order to increase competence within this area and facilitate auditors' review of financial companies.

6.6 Valuation

A fair value for the financial instrument does not always exist on an active market which makes the valuation process difficult and complex. Some of the items in the financial statement are being estimated due to the fact that they cannot be measured precisely, which is called accounting estimates. According to ISA 540 the objective of the auditor is to collect sufficient and appropriate audit evidence to be able to have an opinion if the accounting estimates are reasonable and if the related disclosures are adequate. When financial instruments are not listed on an active market the valuation becomes a complex matter for the companies as well as for the auditors reviewing the companies' financial statements. Respondents 1, 3, 4 and 6 all state that valuation of financial instruments was a problem area during the financial crisis which in some cases caused material misstatements. Respondent 4 believes that the auditor needs to become more aware of the surrounding environment and search for information internationally in order to assess the valuation of financial instruments not listed on an active market and if the interpretation of the standard is consistent with others. Respondent 5 believes that given the difficulties with financial instruments auditors need more knowledge and experience when reviewing a financial company. The respondents believe that valuation to fair value does receive more attention and that auditors do focus more on the valuation of financial instruments today seeing that it was a problem area during the crisis. Respondent 4 explains that valuation issue always has been a complex matter, but auditors are more aware of the problem today and therefore the focus still is on this issue.

The majority of the respondents recognize the valuation problems and do believe auditors focus more on this issue today, however they do not recognize it to be derived from the financial crisis, but seeing that the valuation problem have caused material misstatement, which according to Respondent 3 becomes more drastic during a recession, the awareness of the problem may have occurred in the context of the financial crisis. Another feasible reason which may have increased the awareness of the valuation issue is the fact that IAS 39 was admitted 2008, the same year the financial crisis hit the economy. A new standard follow lack of experience and knowledge for a certain time, this may imply that the valuation problem could be derived from the complexity and newness of IAS 39 rather than the financial crisis.

6.7 Accounting experts

Accounting experts have expertise and are competent within certain areas in accounting and are used to assist and help auditors when reviewing a financial statement. When an auditor is reviewing a company's statement and its financial instruments, the use of accounting experts are common. Respondents 1, 4 and 6 believe that the demand and use of accounting experts has increased. The respondents believe the accounting experts give quality assurance to the auditor, improve and simplify the audit process. Respondent 6 states the use of accounting experts is more common and stricter now due to the problem area of valuation during the crisis. However, the respondents which agree in the increase cannot express whether it is due to the financial crisis or the complexity in the valuation of financial instruments to its fair value. Respondent 5 thinks that the use of accounting experts facilitates learning of new and complex standards and recognizes their importance but does not think the use of accounting experts' services are more common now due to the financial crisis.

Given that only three of the respondents believe that there has been an increase in the demand for accounting experts it is difficult to draw the conclusion that there has been an increase. Whether there has been an increase or not loses its value of interest since the respondents cannot express their opinion if the use of accounting experts is related to the financial crisis or the complexity with valuation of financial instruments. Given that IAS 39 is a relatively new standard which entail the use of accounting experts, the increase in the demand for accounting experts can be explained and

derived from the newness of the financial instruments standard rather than the financial crisis. Change in regulations or economic situations always entail an increase in consulting hours.

6.8 Documentation

The auditor is responsible for the establishment of documentation and the documentation shall be sufficient and appropriate for the auditor's report. Respondents 1, 2, 4 and 6 believe that the requirements for documentation have increased while the other two respondents did not mention an increase in documentation and did not believe the requirements have increased. Respondent 1 states that FI is stressing a higher degree of documentation in the audit process. Documentation is needed for all the work done and the method of working. This is followed by the difficulties of reviewing a financial company and its financial instruments. Respondent 4 thinks the increasing globalization and the fact that business partners are not as familiar with each other today have had effects on the degree of documentation and that documentation is more extensive today. Respondent 2 believe that due to the awareness of the crisis the auditors are more observant and require more documentation on what has happened. The higher requirements follow the difficulties of reviewing financial instruments and the awareness of the crisis as well as FI's interest in audit, this implies that the auditors more thoroughly report how they are conducting their review.

6.9 Communication & Information

In order to improve the audit process seeing the recent criticism and problem areas during the crisis, Respondent 6 states that it has been an improvement in the internal communication in order to discover misstatements and risks easier. He believes the communication with FI will improve in the long run due to the recent criticism. Respondents 1 and 6 shared that increase in the internal information given is another measure taken in order to improve audit. They believe the information today is more focused and directed to certain areas which make the information more useful. Respondent 4 does not agree with the information statement, he implies the information reaches the auditor through many different channels which makes it difficult for the auditor to know what is relevant and what to focus on. The difference in the respondents' answers considering internal information may be derived from the fact that Respondent 4 is from another audit firm than respondents 1 and 6, and internal information channels may differ between the audit firms. Respondent 2 shares that an issue discussed during the meeting with Peter Norman is the need of improvement of communication between FI and the auditors, seeing they have similar purposes in the financial market. Communication and the internal information given have increased to some extent as an attempt to develop auditors' knowledge and improve audit through facilitating the discovery of misstatements, even if disagreements are present.

6.10 Specialization

Given the complex standards and environment in the financial industry, Respondent 1 believes the auditors will have to limit their area of expertise and specialize in financial companies in order to be able to review the financial statements of financial companies in the future. Respondent 6 thinks that the specialization of auditors will facilitate the discovery of misstatements in financial statements, and given that the auditor will improve his understanding of the complex standards within a financial company this may lead to more efficient auditing. He thinks the increasing specialization will have a positive effect on the preparation of a future crisis. Given the risks within financial companies and the complex standards, specialization is necessary and a natural development seeing auditors will detect misstatements and be able to decrease audit risk.

6.11 Criticism towards auditors

Criticism towards auditors has been raised in Sweden in the fall of 2010 in the context of the issue of HQ Bank and the financial crisis. The Swedish Financial Supervisory Authority (FI) and the Swedish minister for financial markets, Peter Norman among others have criticized deficiencies in audit. The respondents believe this criticism has affected the audit business. Respondent 5 thinks the recent criticism has had a greater effect than the financial crisis itself. It is difficult to recognize whether the financial crisis or the criticism and sanctions of FI has affected audit, but what is certain is that FI's criticism does affect audit of financial companies to a certain degree. This however, does not exclude the effects of the financial crisis.

6.12 Confidence

A question raised in the context on the criticism towards auditors in Sweden is if the auditors have perceived lack in confidence. Lack in confidence may be a consequence of the criticism which may affect the auditors. Seeing that the quality of auditors' work cannot be reviewed by the external users themselves the reliability and trust in auditors is based on the reputation of auditors. It is of importance that the belief in auditors is remained due to their importance in the financial system. The confidence in audit has been questioned before. In the Enron scandal the auditors were challenged as not being independent and investors started doubting the reliability in their reports, the criticism affected the whole business negatively. Similarities can be found currently in Sweden, where the media has a negative focus on auditors.

When asking the respondents whether the auditors perceive lack of confidence the answers differed, Respondent 2 believes that the criticism may have affected the public view on audit but have not perceived a lack in confidence from the professionals, which is the opinion of respondents 3, 5 and 6 as well. Respondent 4 does not believe that the degree of confidence has decreased, he states that the decrease in confidence cannot be linked to the whole audit business but it may have affected individual auditors. Seeing that the majority of the respondents believe the criticism has had a effect in some way, either it has affected the public view on the audit industry or individual auditors may have been challenged, we can assume that the negative focus in the media does affect the auditors to a certain degree.

6.13 Expectation gap

Several respondents discussed the source of the criticism and believe it is founded in miscommunication of the role and purpose of audit. Respondents 2, 3 and 5 think that the public is not correctly informed on the purpose of audit and their requirements on the auditors' work are too big and the expectations too high, hence, the expectation gap. The public does not tolerate mistakes from auditors and with these expectations a mistake and fail will eventually occur. The expectation gap does not end in the relationship with the public, another miscommunication issue discussed is between the audit industry and the authority. Respondent 4 states the Swedish minister of financial markets, Peter Norman, and FI are not only interested in the audit of financial statements, they want the auditors to have a more forward-looking role and determine companies' risks. Respondent 5 makes a remark on this statement where she believes FI's requirements are not consistent with auditors' work and purpose today. Respondent 5 and 3 both speculate in future change in audit and believe it will not be enough to convey auditor's role better to the public, the audit process will probably as well need alterations.

After the Enron scandal in the U.S a similar discussion was raised. The need of decrease in the expectation gap between the public and auditor was discussed and this would be altered through better information about the purpose of an auditor. Another example where the expectation gap was challenged was after the S&L crisis in the U.S. The public saw the auditors as “cure-all” which did not correspond with the purpose and role of an auditor. The criticism towards auditors usually follows a crisis and the question of incorrect expectations from the public is raised throughout history. The S&L crisis in the late 1980’s, the Enron scandal in 2001 and now the financial crisis in Sweden are all examples on criticism towards auditors with incorrect expectations on auditors’ purpose. They all follow a need of change and want to convey the role of audit better. As Respondent 5 states, maybe they will have to meet half way, inform the public better as well as change the work of an auditor in the future. Thus, decrease the expectation gap and reduce criticism, which follows a decrease in confidence.

6.14 Experience

Respondent 2, 3, 4 and 6 claims that the auditors may be better prepared for a future crisis due to the experience from this crisis. For example respondent 2 thinks that auditors are better prepared to handle risk issues and Respondent 6 says that experience from crises does prepare you better for a new crisis, but he believes it is easy to forget what you have learned and therefore repeat mistakes. Respondent 2 agrees that people become more alert after a crisis but are more relaxed in better times. Respondent 2 and 6 pinpoint something important. According to Minsky’s theory, people tend to forget previous crises and recessions. Thoughts about future prosperity and growth dominate in a strong economical state, which alter the managements’ mindset and this will lead to economic euphoria that in turn may lead to an unstable economy and a new crisis. Therefore it is important to not exaggerate the impact of experience. People affected by the crisis are more observant during difficult times, but it is easy to forget the lessons learned during a recession when the economy has regained its strength. However, a couple of the respondents believe that one reason that the Swedish economy did not get affected as severely as other countries, is due to the experiences from the crisis in the 90’s, this may show that experience will have some impact on the preparation for a new crisis. Another problem with experience is the transfer of knowledge to new employees in both financial companies and audit companies seeing that experience from a crisis is gained by personally working in a recession.

6.15 Auditors’ mindset

A study was conducted after the Enron scandal in the U.S when the company’s auditors were mentioned in the media in a negative context, this in order to understand the effects on auditor’s behavior. According to the Feldmann and Read article the results concluded that auditors do behave more conservatively when mentioned in the media spotlight, but this is an effect which decreases as time passes. The theory of Minsky addresses that the effect from experiencing a crisis is also decreasing over time. Both the study and the theory discuss an immediate effect on behavior which fades as time passes.

The negative attention towards auditors in the media is now repeated in Sweden. Respondents 1 and 6 think that the auditors are more observant in the risk assessment owing to the recent criticism. They believe auditors are more concerned for the quality of their audit due to the criticism. Not only the criticism affects auditors’ behavior, according to our respondents, the financial crisis may have affected the auditors to a certain extent. Respondent 2 and 3 also believes that auditors are more observant and accurate when reviewing problem areas from the crisis as well as questioning whether the work done is sufficient. Respondent 5 thinks the recent criticism rather than the financial crisis has had an effect, but she does state that if she was an auditor for the banks operating in the Baltic

States she would behave more carefully. Respondent 2 think that the experience of a crisis alters the perspective of an auditor. Auditors become more aware of their importance and their role in the financial market due to the recent focus on financial companies. They do become more aware of the risks.

The study conducted after Enron shows that the criticism does affect auditors' behavior which corresponds with the answers given by the respondents. Considering the respondents answers it shows that the criticism and crisis alter the perspective of an auditor and affect auditors' behavior. The new perspective may decrease over time and awareness of the fading effect may extend the altered mindset.

7 Conclusion and discussion

This chapter presents the conclusion of this study based on the analysis in the previous chapter. Furthermore, a discussion is conducted considering the conclusion and latter a proposition on further studies is presented.

7.1 Conclusion

Pervading changes and effects has not occurred throughout the entire practical work of an auditor. However, the financial crisis and criticism has affected parts of the practical work and therefore an affect has after all occurred. A conclusion considering auditors behavior can be made seeing that all respondents believe the auditors' behavior is affected by the financial crisis and the recent criticism.

The valuation of financial instruments at fair value was the most important problem area during the crisis which caused several material misstatements. The focus on the valuation issue when conducting a review is more present and important today, but the change in focus has not clearly changed due to the financial crisis or criticism. Besides valuation of financial instruments, other material misstatements such as credit loss and goodwill may have changed auditors' focus due to the crisis, seeing that these misstatements were problem areas during the financial crisis. The complexity in valuation has increased the demand for accounting experts, but not as an affect from the financial crisis or criticism. The respondents disagree in the change of audit evidence. However, we find that the respondents imply that changes have occurred and can be derived from the crisis and criticism. The auditors focus more on the test of internal control when conducting audit for a financial company due to the recent criticism. Higher requirements for documentation in audit have changed due to both the financial crisis and the recent criticism. Internal information and communication has increased to some extent in order to facilitate the discovery of misstatements and risks, and is therefore a change due to the financial crisis. Communication between the auditors and FI has not yet changed, but will probably improve due to criticism. Specialization seems to be more important owing to the crisis in order to conduct audit for financial companies and will probably increase in the future. The financial crisis has changed the experience of auditors, which will change their behavior. However, the risk of a fading effect is present. Auditors behavior and mindset has altered, the auditors are more observant and accurate due to the financial crisis as well as more concerned for quality due to the criticism. Change in confidence for auditors may have occurred and decreased among the public owing to the criticism. The source to the criticism may lie in the expectation gap which in the long term may alter the audit process as well as the role and purpose of the auditor.

7.2 Discussion

During the work of this study we have encountered several interesting issues. When a crisis hits the economy it endangers the financial markets and can end in a financial collapse. Seeing that the financial industry is crucial for a working economy an ongoing discussion in context of audit and accounting may alter the audit process and regulations within accounting in the future, which implicate that the work of an auditor will become even more extensive. Increase in resources and time will be needed in order to conduct audit for a financial company considering all the requirements and regulations. This development may be introduced in order to secure the financial companies survival and maintain belief in the financial system, but other consequences may follow as well. Given the extensive work, consulting hours and audit hours will increase, and with it the costs. Both the higher requirements and possible increased costs may lead to disappearance of smaller financial institutes and a market economy with only the biggest financial operators. The

stakeholders benefit from audit and a more extensive audit would profit stakeholders. However, the benefit of a possible improved but more extensive audit has to exceed the cost in order to be sustainable.

7.3 Suggestions for further studies

The role and purpose of an auditor in the market economy is an interesting subject in different aspects and contexts.

- This study was limited to auditors' practical work and behavior, another aspect of interest is changes in regulations that auditors need to relate to, and how the increasing and complicated regulations affect the audit business.
- A change in the practical work of auditors is the increased focus on internal control when performing audit on financial companies. It is discussed whether it should be mandatory to test internal control in the future. It would be of interest to examine the effects of the increased test of internal control, both for the audit business and financial companies. An aspect to consider is efficiency.
- Considering the criticism towards auditors throughout history and the expectation gap as a source to the criticism, it would be of interest to examine changes made in order to decrease the expectation gap. The study could be limited to a certain time period with several cases of criticism following a crisis or a scandal.

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