



UNIVERSITY OF GOTHENBURG  
SCHOOL OF BUSINESS, ECONOMICS AND LAW

# **The Abrogation of the Statutory Audit**

Effects on the Swedish Tax Authority,  
from an Agency Theory Perspective

**University of Gothenburg**  
**School of Business, Economics and Law**  
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## **ABSTRACT**

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### **Title**

The Abrogation of the Statutory Audit, Effects on the Swedish Tax Authority - from an Agency Theory Perspective.

### **Background and problem**

The statutory audit for small LLCs in Sweden was removed in 2010. The Swedish Tax Authority raised many concerns before the legislative change, but since then they have not voiced their opinions regarding its effects. They lost a tool to ensure that the information that they receive from the company is correct, but it is unclear how this has affected their work processes.

### **Aims of study**

The aim of this study is to investigate the Swedish Tax Authority's current views on the legislative change. Also, the subject of the value of the external audit and how it might have an effect on the information asymmetry that can arise in the Principal-Agent relationship between the Swedish Tax Authority and the Swedish LLCs.

### **Research questions**

How has the abrogation of the statutory audit for small LLCs affected the Swedish Tax Authority?

Is the external audit useful to redress the information asymmetry between the Swedish Tax Authority and the Swedish companies?

### **Methodology**

A qualitative study with individual interviews with five employees at the Swedish Tax Authority and one interview with the Chief Legal Officer at the Swedish Companies Registration Office. In addition to this a selection of articles, on the value of audit as well as on the subject of the abrogation in different EU member states, have been studied.

### **Analysis and conclusion**

The abrogation of the statutory audit has not affected the Swedish Tax Authority as much as they feared it would. The General Accounting Controls, that were concurrently implemented, is perceived to be more beneficial than the external audit. The most important tool to redress the information asymmetry is a continuous contact between the company and an objective external party with relevant knowledge in accounting and in the company. It is of less importance whether this person is an external auditor or an accounting consultant.

### **Keywords**

Statutory Audit, Tax Authority, Sweden, Small LLCs, General Accounting Controls.

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# 1. INTRODUCTION

In this introductory chapter, we will give a review and a presentation of the problem area that we have chosen to focus on in our thesis. Thereafter, we will present a general description of the problem area, which will then lead to the aim of this study. Subsequently, we will present our research questions and briefly explain the chosen research method, as well as clarify the limitations of our thesis. At last, some central concepts will be explained.

## 1.1 Background

Sweden imposed a statutory audit as early as 1944, stating that all larger limited liability companies (LLCs) were obligated to have a qualified auditor. In the 1970s, Sweden experienced an increase in economic crime, mainly in the small companies, resulting in a legislative change in 1983. Now, all LLCs were obligated to have an external auditor (SOU 2008:32).

The European Union (EU) has, in its Fourth Council Directive, allowed companies with limited liability to be exempted from the obligation to have an external auditor. Several other member states have chosen to exercise this exemption in their regulations, which is why small private companies in Sweden were previously imposed by an additional cost for audit, which their foreign counterparts were able to avoid (SOU 2008:32).

In 2006, the Swedish Government initiated an investigation to compile a memorandum regarding the statutory audit for small companies in Sweden. The memorandum was presented in March 2008 (SOU 2008:32). They proposed an abrogation of the statutory audit for small companies, concerning both the audit of the annual statements and the management audit. Another proposal was that the Swedish Tax Authority should be able to do continuous reviews Swedish companies, so-called General Accounting Controls.

By making these legislative changes, the government hoped that the small Swedish companies would be able to compete better on the international market, since the conditions would be more equal (SOU 2008:32). The statutory audit for small LLCs in Sweden was removed in November 2010 (Swedbank 2010).

## 1.2 General Description of the Research Problem

Sweden was one of the last countries within the EU to adopt the abrogation, while only coming before Norway when compared to the other Nordic countries. The Swedish government estimated that the loss in tax revenue would add up to 1.3 billion SEK as a result of the legislative change, while the small companies would enjoy a joint saving of 2.5 billion SEK. Small companies were already, before the change, considered to make a disproportionate amount of errors in their tax returns (Lennartsson 2010-c). However, results from other European countries do not give evident support for a possible increase in the errors as a result of the legislative change.

In Denmark, the frequency in errors in the tax returns from small LLCs that chose not to have an external auditor was 29.5 per cent in 2010, in comparison to 24.4 per cent among those keeping the audit. While the Danish Ministry of Taxation considered this to be “not significantly higher” and within the margin of error, the Swedish equivalent thought that it confirmed their fears - that the need for their ex post controls would be higher for a non-audited company than for a company that employs an external auditor (Lennartsson 2010-b).

In 2012, two years after the legislative change, nearly two out of three of the Swedish newly established small LLCs had made the choice not to have an external auditor (Nordström 2012).

The main reason for removing the statutory audit for the small LLCs in Sweden was that it would help them to save money and thereby become more competitive towards companies in countries that had already removed the statutory audit, or had never administered it (SOU 2008:32). On the other hand, the abrogation might also have led to a decrease in the quality of the accounting and the annual statements of the small LLCs, as well as a lack of accounting competence when these companies do not take advice from an external auditor. As a result, an information asymmetry between the companies and the Swedish Tax Authority might have arisen.

After the abrogation, the Swedish Tax Authority might have lost a tool, the external audit, in their work to ensure that no ambiguities or errors take place in the small LLCs in Sweden. This might have led to a larger information asymmetry between the two parties since it has become harder for the Swedish Tax Authority to ensure whether the information from the companies is correct or not. However, the abrogation also extended the possibility for the Swedish Tax Authority to do reviews throughout the year. Prior to the legislative change, the Swedish Tax Authority was mainly able to perform reviews of the companies' accounting after the end of the fiscal year. These new continuous reviews might be able to redress the information asymmetry better than the external audit can.

While it is still too early to state all the effects of the abrogation on tax errors and the economy, the Swedish Companies Registration Office has experienced some effects already. In a press release from 2012, they stated that the quality of the annual statements from 2011 had decreased compared to the annual statements from 2010. They had also experienced an increase in delays concerning the submission of the companies' annual statements (Nordström 2012). These facts could indicate that the risk for information asymmetry between the two parties might be higher after the abrogation of the statutory audit than before the legislative change.

The last of the three referrals to the Council on Legislation, based on the memorandum from 2008, was set up by the government in November 2012. In an article in this year's first edition of *Balans*, Magnus Graner, the undersecretary for the Minister of Justice Beatrice Ask, gave some comments on the most recent developments. Graner stated that the politicians are developing further stages to simplify the establishment of annual statements and tax returns for small LLCs, hoping to be able to give more information during 2013 (Lennartsson 2013).

## **1.3 Aims**

The aim of this thesis is to study the Swedish Tax Authority's current views on the abrogation of the statutory audit for small LLCs and how this has affected their processes. We wanted to find out whether they see a value in the external audit or they prefer other methods to ensure that the taxation is correct.

We also wanted to find out whether the Swedish Tax Authority sees the external audit as a helping hand in minimizing the information asymmetry that might arise between the companies and the Swedish Tax Authority when there is uncertainty whether the information, given by the companies, is correct or not.

## **1.4 Definition of the Research Problem**

In Sweden, there is a strong relationship between accounting and taxation; the statement of revenue is based on accounting laws and generally accepted accounting principles (GAAP). The external auditor should express whether the accounting gives a true and fair picture and whether the company pays its taxes on time (Knutsson, Norberg and Thorell 2012). Thus, the external audit is an additional control, aiming to prevent and hinder the occurrence of errors and economic crime and which might act as a type of quality assurance.

We assume that the Swedish Tax Authority could have an interest in the accounting. If errors go undetected it could lead to incorrectly calculated taxes, which in turn could result in lower tax revenues. If the Swedish Tax Authority had to increase their controls in order to decrease the risk of undetected errors, that earlier might have been detected by the external auditor, they would need more resources to enable them to get access to the relevant information.

In the absence of an external auditor, an entrepreneur, who sets up his or her own accounting and lacks the sufficient knowledge, risks submitting inaccurate annual statements to the Swedish Companies Registration Office. The Swedish Companies Registration Office keeps a register of Swedish companies from which they supply other parties with information, including the Swedish Tax Authority (The Swedish Companies Registration Office 2013). If this information is incorrect, it could later lead to further issues when it is used in analyses and calculations, as well as when the entrepreneur submits the return of income.

This reasoning leads up to our research questions:

- How has the abrogation of the statutory audit for small LLCs affected the Swedish Tax Authority?
- Is the external audit useful to redress the information asymmetry between the Swedish Tax Authority and the Swedish companies?

## **1.5 Research Method**

We started by looking at information in research articles and from different web resources, in order to chart the background of our research area. This information then formed the basis for our qualitative study, in which we performed interviews with employees at the Swedish Tax Authority and the general counsel at the Swedish Companies Registration Office. We will describe our research method further in the second chapter of the thesis.

## **1.6 Delimitations**

The focus of this thesis is the effects of the abrogation of the statutory audit for small LLCs on the Swedish Tax Authority's preventive work and their control methods. The empirical findings have mainly been obtained from interviews with employees at the Swedish Tax Authority. Thereby, this thesis is limited to the opinions of employees at the Swedish Tax Authority, regarding the effects of the abrogation. However, we have taken into consideration the impressions from the Swedish Companies Registration Office concerning the possible change in the quality of the information from the small LLCs. We have not studied different companies' annual statements, because our focus is on the Swedish Tax Authority's views on, and confidence in, this information, not the information itself.



We have looked into the experiences of other countries within the EU that have abrogated the statutory audit for small LLCs, though we have limited our research to only include experiences from Denmark, Finland and England.

## 1.7 Central Concepts and Abbreviations

<b>Articles of association</b>	The constitution and regulations of a registered company.
<b>Audit of annual statements</b>	An audit reviewing the correctness of the books of accounts and the annual statement.
<b>Auditee</b>	A company that has been subject to an audit.
<b>CEO</b>	Chief Executive Officer.
<b>Company</b>	A business enterprise.
<b>FAR</b>	The professional institute for authorized public accountants, approved public accountants and other highly qualified professionals in the accountancy sector in Sweden.
<b>General Accounting Controls</b>	Continuous reviews performed by the Swedish Tax Authority.
<b>Intentional tax errors</b>	Errors made to avoid taxes, including economic crime.
<b>LLCs</b>	Limited Liability Companies.
<b>Memorandum</b>	A summarized report concerning something to be acted upon in the future.
<b>Management audit</b>	An audit of how the company is managed and how well the internal controls function.
<b>Statutory audit</b>	An audit that is imposed by law, that forces companies to have an audit.
<b>Unintentional tax errors</b>	Errors made because of lack of knowledge or by mistake.

## **2. METHOD**

In this chapter, we will start by explaining our selection of research area and our research approach, in order to enable the reader to get a broad insight into the methodology of the study. Thereafter, we will describe the empirical data collection in depth, together with our selection of research objects. This leads up to a reflection regarding the reliability and the validity of these interviews. Then we will describe the process of collecting secondary data, before describing the method that we have used for the analysis of the gathered data. Concluding this chapter, we criticise the sources that we have used, reflecting upon both their reliability and their importance for this study.

### **2.1 Selection of Research Area**

During our time at the School of Business, Economics and Law at the University of Gothenburg, we have studied business and focused in depth on our interest area accounting. We are both aiming at working as auditors after graduation, but the possibilities to study such areas have been limited during our bachelor programme. We wished to study the value of audit and its purpose more in depth.

Our selection of stakeholder, the Swedish Tax Authority, was mainly based on the fact that, since the abrogation, they have not publically voiced any concerns regarding its effects on them and nor has this particular area been investigated by researchers. Therefore, we thought it would be interesting to study their views on the matter.

Studying previous theses concerning the abrogation, the focus has been on the expectations and not the actual results. A reason for this could be that the legislative change happened recently. We found a students' thesis from 2012 that investigated the views of an employee at the Swedish Tax Authority and employees at a number of small LLCs, but during the process the students realised that the study was performed too early to be able to investigate the results.

Now, in 2013, the Swedish Tax Authority has performed the taxation of the fiscal year 2011, which is the first year for which the small LLCs had an actual opportunity to opt-out of an external audit of the annual statements.

### **2.2 Selection of Research Approach**

As mentioned earlier, the aim of this study is to describe, analyse and interpret the Swedish Tax Authority's reactions to the new legislation regarding the statutory audit. A qualitative study has been performed, evaluating the effects on the Swedish Tax Authority's work and whether the fears, expressed in their statement of opinion, came true. With a hermeneutic approach, we have performed a survey on the chosen population, namely the Swedish Tax Authority.

In an evaluative study, it is crucial to be conscious of the aim and the recipients throughout the process. The research is rarely fully objective and the influences of the interested parties have to be considered (Lundahl and Skärvad 1999). The aim of this study was to examine the population's views of the external audit, why the opinions risked being subjective and inadequate in reflecting other parties' views. However, in selecting the interview objects from

different units of the Swedish Tax Authority and comparing their answers, the ambition was to isolate personal opinions and focus on the authority in general.

The core of the hermeneutic approach is to study an environment from the viewpoint of the surveyed selection, in order to understand their motives. The surrounding environment influences the study, which is why the problem definition and the theoretical framework should be developed throughout the study (Lundahl and Skärvad 1999). This study has been a continuous process and the theoretical framework has been extended and shortened during the process of collecting the empirical findings. To nuance the findings, an interview with the Chief Legal Officer at the Swedish Companies Registration Office has also been performed.

The choice to perform a qualitative study was mainly based on the ambition to receive in depth answers and to understand the motives and meanings of them. The interpretation, to relate the findings to each other, is central in a qualitative research. The main questions to answer are: “is the interpretation consistent and coherent?” and “is it rooted in theory?” (Lundahl and Skärvad 1999). It is also of great importance to ensure the reliability and the validity of a study (Blumberg, Cooper and Schindler 2008).

We have chosen to perform an inductive analysis, which is derived from specific examples instead of probability samples (Lundahl and Skärvad 1999). The cases have been selected based on the belief that the relevant knowledge would be collected. The accumulated data has then been categorised and interpreted.

Through this process, we should be able to achieve a better understanding of and insights into the research area and thereby make a meaningful interpretation of the situation (Lundahl and Skärvad 1999).

## **2.3 Empirical Data Collection**

### **2.3.1 The Swedish Tax Authority**

When we first approached the research area, we did not know what the Swedish Tax Authority’s attitude towards the legislative change was. In the statement of opinion from 2008, they expressed a fear that the quality in the small LLCs information would be lower (The Swedish Tax Authority 2008), but since the change they have not raised many concerns.

To investigate their position in the matter and observe the results of the abrogation, a qualitative study seemed to be the only available approach. We have therefore performed five interviews, in person, with employees at the Swedish Tax Authority.

The interview process should be a balance between the structured interview’s quantifiable data on the one side and the depth and the nuances of a free interview on the other. For a study researching “soft” values, such as personal judgements, the free interview is generally more appropriate (Lundahl and Skärvad 1999).

According to Myrdal (1969), a researcher’s standpoint, the way the researcher finds, selects and analyses the findings, is always influenced by his or her values. In order to achieve objectivity, a researcher needs to bring these values forward, chart them and clarify how they have affected the research. Another way to reach objectivity is through intersubjective verifiability, where another researcher with the same qualifications and postulations, who were to perform an identical research, would achieve the same results. Thus, the results would be independent of the researcher. According to his viewpoint, using an objective method guarantees a research’s objectivity (Myrdal 1969).

In order to perform an objective study, combined with the benefits of a free interview, a semi-structured interview guide has been created, where we aim to achieve intersubjective verifiability.

With a semi-structured interview, there are general areas for all the interview objects to answer while there is still room for personalised questions and spontaneous discussion. It is better suited for questions regarding personal opinions and impressions. This is a survey of the Swedish Tax Authority's opinions, but with regard to budget constraints only a limited number of people was selected, which is why it was necessary to have a measure of standardisation in order to be able to quantify the answers and draw conclusions regarding the whole population (Lundahl and Skärvad 1999).

### **2.3.1.1 Selection of Interview Objects**

Some of the benefits of an interview performed in person are that the more complicated questions can be expressed, as well as some follow-up and clarifying questions. There are disadvantages however, mainly the time constraints and the availability of interview objects (Lundahl and Skärvad 1999). It being a public authority, we believe that the working methods of the employees at the Swedish Tax Authority do not differ depending on which office we select to perform the interviews at. The employees have therefore been selected depending on their perceived knowledge and qualifications rather than their location. By contacting the interview objects at an early stage, we have been able to perform all of our interviews in person.

Advantages of sampling, compared to a census, are mainly the lower costs and the shorter time needed. Also, we do not believe the opinions of the employees at the Swedish Tax Authority to have such a wide spread as to require a census study (Blumberg, Cooper and Schindler 2008). The appropriate number of objects to interview was hard to define; the ambition to meet as many as was necessary in order to collect the information was balanced with the time constraint.

A large sample is not a guarantee for quality; the size should rather be a function of the variations in the studied parameters as well as the necessary estimating precision (Blumberg, Cooper and Schindler 2008). The dispersion within the chosen population seemed small and therefore a sample of five employees at the Swedish Tax Authority was chosen.

We used the method snowball sampling to find the interview objects. The first contact and interview was with Maria Berglund, an employee at the department for economic crimes at the Swedish Tax Authority. Berglund then supplied the name of a person who is participating in the adjustment work, Kerstin Lundgren. During the interview with Lundgren, she was asked to refer to a possible interviewee with whom the third interview was performed.

This sampling method was used in order to find people with the relevant knowledge for the research, but to add to the objectivity, two parallel snowball processes were performed. The interview objects are not colleagues from the same unit, but rather referred to based on knowledge of their qualifications.

Snowball sampling is a non-probability sampling technique, which does not provide estimates of precision (Blumberg, Cooper and Schindler 2008), but since the focus of this study is on finding qualitative rather than quantitative data, this method was considered more appropriate in order to select the candidates with the relevant knowledge. With a small sample, it was important that the interview objects possessed the relevant knowledge and motivation to participate (Blumberg, Cooper and Schindler 2008), why this technique was selected.

### **2.3.2 The Swedish Companies Registration Office**

In addition to the study at the Swedish Tax Authority, an interview has been performed with Per Nordström, Chief Legal Officer at The Swedish Companies Registration Office. For this interview, the same methods were used but the questions were adjusted to fit a new interview guide, created specifically for The Swedish Companies Registration Office. Nordström participated in the development of the memorandum and in addition to his experiences from that process, the intention was to ask him about the Swedish Companies Registration Office's experiences after the legislative change.

The focus of this interview was the information that the Swedish Companies Registration Office receives from the small Swedish LLCs. We wanted to find out whether the quality of the annual statements has changed, which in turn could indicate that the quality of the accounting, the basis of taxation, has worsened.

### **2.3.3 Validity and Reliability of the Empirical Data**

In short, reliability means the consistency in the results while validity ensures that the aim of the study is fulfilled (Kvale and Brinkman 2009). By explaining the research method, the reader can more easily estimate the validity and reliability of the study, which can in turn increase his or her confidence in it (Blumberg, Cooper and Schindler 2008). The reliability of this study has also been increased by attaching the interview guides to this report.

Since this study has been made on a very limited sample, the reliability of the study is complicated. To ensure the quality of the sample, the spread of the interviewees' qualifications has led to accuracy and precision. If the objects were to answer similarly, it would increase the reliability of the study. An interview guide with open-ended questions has been used for all the interview objects in our sample from the Swedish Tax Authority. Using this method, the ambition was to achieve open discussions and material from which conclusions could be drawn, regarding the authority in general.

We constructed the questions so that they would be understood in the same way by all the interview objects, with the ambition to achieve intersubjective verifiability. The questions were designed with regard to the research questions, the literature review and the theoretical framework. The questions have an open structure, in order to give room for the interview objects to add information stretching beyond our previous competence.

After each interview, we immediately started the transcribing of the recorded material, in order to have our impressions and thoughts fresh and to add our impressions to the material. To further ensure the validity of the interviews, we sent the transcribed work to the interviewees to clarify any ambiguities. By doing this, we also confirmed that we had registered the interviewees' opinions correctly.

Nevertheless, it is important to remember that the interviews were held in Swedish and then translated into English in the process of compiling the empirical findings. By doing this, some of the nuances in the recollections risk being lost in the translation. However, we feared that if the interviews were to be held in English, the interviewees could have been restrained by the language barrier. After these reflections, the decision was made to perform the interviews in Swedish and then later translate and process the material.

Regarding the interview at the Swedish Companies Registration Office, this part of the study was limited to include only one interview object, the Chief Legal Officer Per Nordström. As previously stated, the focus of our study is the Swedish Tax Authority and therefore most of

the time was put into investigating their opinion. The interview with Per Nordström was performed with the ambition to get an indication of how the quality in the accounting has changed.

## **2.4 Secondary Data**

Adding to the findings from the interviews, we have looked at documents from different authorities as well as a couple of organisations' statements of opinion found on the Internet. The Swedish Tax Authority's statement of opinion from 2008 was not available online, and we therefore received it by email from one of the employees. We have also studied articles on external audit and experiences from other countries that abrogated the statutory audit before Sweden.

The limitations to these secondary sources have to be considered by looking at the purpose, scope, authority, audience and format of the information; source criticism is crucial (Blumberg, Cooper and Schindler 2008).

Since the abrogation of the statutory audit for small LLCs in Sweden is a recent legislative change, not a great deal of research has been done on the subject. The articles on the abrogation of the statutory audit that are included in this thesis concern Denmark, England and Finland. These countries are all members of the European Union and have to follow the Fourth Council Directive. Denmark and Finland have similar business climates to Sweden and England was added because they have a long experience from the abrogation, since they made the change as early as 1994. However, the selection of articles was based on the ability to display possible implications of the abrogation rather than to compare the countries to each other.

We have used these sources in order to increase the depth of the analysis. Throughout the process, the information has been evaluated regarding quality, relevance and usefulness for the research problem addressed; some parts of the theoretical framework have been added at a later stage of the process and others have been removed. In order to evaluate the sources according to the aforementioned factors, the recipients of the information and the intended purpose of the information have also had to be considered (Blumberg, Cooper and Schindler 2008).

Thus, we have performed both a quantitative and a qualitative content analysis, measuring both the content itself and the cognition of it.

## **2.5 Method for analysis**

After the data collection, the material has been processed and compiled in order to analyse our findings and aim at answering our research questions. Thoughts and ideas have arisen throughout the process, which we have reflected upon and written down and saved for later analysis. When we have looked at the material at later stages, new thoughts have been added, while the original ideas have not been forgotten.

When our interview objects had approved and returned the transcribed material, we read through it and highlighted the most relevant areas, which we planned to include in our thesis. Thus, not all of the collected data will be presented in this thesis. Next, in relating this material to the literature, six key areas were selected, which later became the subheadings of the section *Empirical Findings*.

The processing of the material continued by entering some of the exact quotes from the interview objects, regarding each key area. These quotes were then compiled and compared in order to find the interviewees common, as well as differing, opinions in the matters. This compiled material was edited and became the section *Empirical Findings*. Rather than reading up on the separate questions asked and the answers received, the section consists of running text, which was considered to better bring the similarities and differences forward.

When the work with the *Analysis* section of this thesis was initiated, the empirical findings were again studied, alongside the literature and the notes taken along the way. This resulted in the section *Analysis*, which was then the basis of the conclusions of this thesis, answering the research questions that were formulated in the beginning.

## 2.6 Source Criticism

It is important to have a critical viewpoint on the sources that have been used in the study, and therefore the sources used have been questioned and evaluated regarding their importance for answering the research questions.

The stories told by the interview objects could be partial, but when several of them tell the same story it increases the truth-value of their recollections. The focus of the study is the Swedish Tax Authority and the findings have been nuanced by comparing the stories to the theoretical framework.

In agreement with the interview objects, their names and work positions have been published, in order to give a greater understanding of the different perspectives that they might have. The choice not to have anonymous respondents can complicate the openness and honesty of their answers. However, by sending the transcribed material to the interview objects for them to review, they appeared more relaxed and more willing to give trustworthy recollections.

The abrogation of the statutory audit for small LLCs in Sweden was made relatively recently, which is why not a great deal of scientific research has been done concerning the effects that it has led to. Therefore, the secondary data has mainly been derived from articles concerning research done in other countries that removed the statutory audit earlier than Sweden. A possible effect of this is that these observations might not be applicable to the Swedish abrogation of the statutory audit, since the business and legal environment in Sweden might be different from the countries in these articles.

A great deal of the secondary data is derived from the memorandum SOU 2008:32. Reports and statements issued by the government or governmental authorities are often considered to be reliable.

Regarding the sources that originate from web sites, we have chosen to mainly use sources from well-known organisations or associations, such as FAR. We believe that this has increased the reliability of the facts since these sources are of greater reliability than newspaper articles or websites from less known companies, where the facts are more likely to have been influenced by the author's opinions (Blumberg, Cooper and Schindler 2008).

# 3. LITERATURE REVIEW AND THEORETICAL FRAMEWORK

In this chapter, we will begin by describing the Swedish memorandum that led up to the legislative change. For an increased understanding, we will continue by giving a short explanation of accounting and how it relates to taxation. We will then describe what audit is and what its purpose is. Thereafter, we will account for one of the theories of the firm, the Agency Theory, which regards the relationship between a company, or its management, and different external parties. In this part, we will also present a revised model of the Agency Theory, which we will use in our analysis. Then, some findings about tax compliance will be explained briefly. Finally, we will describe the developments of the statutory audits in Denmark, Finland and England, which all have exploited the exemption from the statutory audit given in the Fourth Council Directive of the EU.

## 3.1 The Memorandum SOU 2008:32

On April 3rd 2008, the Swedish government presented a memorandum that proposed legislative changes concerning the statutory audit for companies in Sweden. The main proposal was that the statutory audit of annual statements should be removed for all forms of companies that have fulfilled less than two of the following criteria during the last two fiscal years:

- 1) A balance sheet total of more than 41.5 million SEK,
- 2) Total net sales of more than 83 million SEK, and
- 3) More than 50 employees (SOU 2008:32).

The memorandum further proposed that the management audit should not be mandatory for the companies that would be exempted from the statutory audit of their annual statements.

One of the organisations that gave their opinion regarding these proposals was the Swedish Tax Authority. The Swedish Tax Authority advised against the abrogation of the statutory audit, both the audit of the annual statements and the management audit, for the small companies. One of the main arguments that they presented was that the statutory audit prevents both intentional and unintentional errors and therefore it is a good tool to ensure the correctness of the information that the companies submit. The Swedish Tax Authority further accentuated that most of the errors are made by small companies, and thus, these companies are the ones who are in the greatest need of a statutory audit (The Swedish Tax Authority 2008).

Other organisations, such as the Swedish Federation of Business Owners (2008), the Swedish Companies Registration Office (2008) and the Swedish Banker's Association (2008), were positive to the abrogation and welcomed it even though some of the parties thought that it should be investigated further. The main reason for their positive attitude was that they appreciated the possibility for the Swedish companies to compete on equal terms on the international market. Even Hans Börsvik (2008), then vice President of the audit firm PwC, welcomed the possibility of a demand-driven audit industry.

Furthermore, the memorandum proposed that the Swedish Tax Authority should be given the possibility to do continuous reviews of companies during the fiscal year, and not only at the end of the year, to ensure that no ambiguities or errors take place (SOU 2008:32). The



Swedish Tax Authority (2008) was positive to this proposal and believed that the continuous reviews could have a preventive effect, given that the reviews were made during unannounced visits to the companies. However, they stressed that this method would require further resources for them and that there should be a sanction that could be levied upon the companies that did not meet the requirements. The Swedish Federation of Business Owners (2008) were not of the same opinion as the Swedish Tax Authority. They argued that these continuous reviews would lead to an increased risk of injustice between the companies, since the Swedish Tax Authority might be more inclined to review the companies that had chosen to not employ an external auditor.

Another proposal made in the memorandum, and later implemented, was that the companies would be obligated to give notice in their tax return whether they have an external auditor or not, and whether they had had any help, such as an accounting consultant, while establishing the books of accounts (SOU 2008:32).

The main argument for an abrogation of the statutory audit, presented in the memorandum, was that an abrogation would decrease the costs for small companies, and thereby make them more competitive towards companies in other countries that did not administer a statutory audit (SOU 2008:32).

When the legislative change was introduced in November 2010, the criteria had been changed to the following:

- 1) A balance sheet total of more than 1.5 million SEK
- 2) Total net sales of more than 3 million SEK, and
- 3) More than 3 employees (SFS 2005:551).

## **3.2 The Relationship Between Accounting and Taxation**

According to Swedish law, most legal entities as well as all natural persons and decedent estates that pursue business operations are obligated to keep books of accounts (SFS 1999:1078). The main purpose of the bookkeeping is to provide material for decision making, both for the people inside the business and for its external stakeholders (Thomasson et al. 2007).

In general, these books of accounts act as basic data when the companies form their returns of income (Thomasson et al. 2007). This relationship between accounting and taxation means that the accounting of a company defines when revenues should be taxed and when expenses should be deducted from the taxable income. Thus, the accounting determines which year, or accounting period, the revenues and expenses should be referred to (Kellgren and Bjuvberg 2008).

Sweden is considered to have a strong connection between accounting and taxation. However, despite the apparent connection, the legislation in the two areas uses different methods for calculating a company's income. A reason for this complication is the recipients of the information; the stakeholders, the accounting should reflect the relevant information for the investors and others, while the tax legislation aims to ensure that the government can tax businesses fairly. In short, accounting rules are "soft" while tax legislation is more strict (Knutsson, Norberg and Thorell 2012).

An example of a collision between the two areas of legislation is the valuation. In taxation, it is important not to set the value of an asset too high and not to undervalue a debt, while in the accounting of a company, the participants strive to do the opposite. Because of this, the

demands on the companies' evidence are generally higher regarding the taxation than those regarding the accounting (Knutsson, Norberg and Thorell 2012).

In addition to this, the accounting rules differ in some ways depending on whether it is a small or a large corporation, while the tax legislation essentially is the same - regardless of company size. The classifications and accruals made in the accounting affect the basis of taxation (Knutsson, Norberg and Thorell 2012).

The tax legislation should ensure the fiscal interests of society, but there are limits to how far the regulations can go. The general principle is that the basis of taxation follows the accounting and, in general, this does not cause any issues. The problem rather relates to the questions of accruals, which do not affect the definite tax gains or tax losses (Knutsson, Norberg and Thorell 2012). Decisions have to be made regarding the classification; whether to defer costs or not, which affects the tax liability and deductibility. An example of this is the capital gain or loss from selling the shares in a subsidiary, which in general is neither tax liable nor tax deductible (SFS 1999:1229). The two legislative systems can cause issues for entrepreneurs who lack the relevant knowledge and become lost in the process.

An auditor states whether the GAAP have been followed. If he or she discovers that they have not, the auditor should announce this. The Swedish Tax Authority could deviate from the material received from the companies and assess according to the principles.

The external auditor is not allowed to establish a company's books of accounts and does only sometimes review its tax returns. Besides, the annual statements, a part of the basis of taxation, have only sometimes been audited before the tax return is handed in. The main purpose of the external audit has not been to accommodate the government's interests and there is only a minor relationship between the audited annual statements and the tax returns. The external auditors' responsibilities have been extended however, to include more stakeholders, including the government and its claims on taxes (SOU 2008:32).

### **3.3 External Audit**

External audit is defined as an independent review of a company's, or other organisation's, accounting and management, made in retrospect (Revision 2013, Nationalencyklopedin). The main purpose of the external audit is to verify that no inaccuracies or infringements have occurred and that the managers work for the good of the company (FAR 2002). For the companies where the owners are not fully responsible for the company's debts, the law states specific requirements for how the information about the company's financial position should be presented. It is important that the stakeholders can trust this information and through the external audit they can acquire an independent review of the information's reliability (FAR 2002). The external auditor, having limited time, has to assess which areas to control, based on essentiality and risk. An external audit is not a guarantee for a correct accounting, but might increase the reliability of the information (Knutsson, Norberg and Thorell 2012).

There are several parties that take an interest in the external audit of a company, such as the owners of the company, banks, and the state and its authorities (FAR 2002). The tax authority of a country, for instance, might have an interest in the external audit, since it ensures that the accounting of the company is correct and trustworthy. The accounting affects the tax and income returns and is therefore of the utmost importance to the Swedish Tax Authority (FAR 2002).

### 3.4 Confidence and External Audit

Audit is built on trust (FAR 2001). The basic demands on external auditors, for the surrounding environment to be able to confide in them, are competence, independence and confidentiality (FAR 2001).

If an external audit was performed without the above stated demands, or if no audit was performed at all, an information asymmetry could arise: the recipients might not be able to verify that the financial information from a company is trustworthy. The consequences of information asymmetry are explained in the theory “Market for Lemons”. Asymmetric information could create insecurity about the quality of the product offered. An effect of the insecurity about quality is incorrect pricing, thus high quality goods can be sold at a low price and goods with low quality can be sold at a high price (Akerlof 1970).

Applied on external audit, this means that non-audited companies might be evaluated based on information that is less trustworthy than that of audited companies. Dedman and Kausar (2012) claim that English audited companies reported more conservatively than the non-audited companies. The non-audited companies were more optimistic in their accounting and recognised income-reducing incidents more slowly and income-ascending incidents faster, than the companies that had kept the external audit, which might risk giving an excessively positive picture of the company’s financial situation (Dedman and Kausar 2012). As a consequence, the information might lead to incorrect calculations of the consolidated income of the company and hence the taxes that the company should render could be incorrect.

In a comment to the European Commission’s legislative developments regarding audit, Doralt et al. (2012) also raised concerns regarding the lack of trust that might arise if an audit is not performed in a credible way. This lack of trust, when management’s errors might not be detected, can lead to increased costs of trade and in the long run there is a risk for the markets to collapse.

According to a study by Maijoor and Vanstraelen (2006), a strict audit quality regime can lead to a business environment where companies are less likely to engage in earnings management. Earnings management means that a company does not apply the GAAP as they are intended, but instead choose to plan the accounting in a way that is beneficial for the consolidated income and the balance sheet. In other words, they enter revenues and expenditures into the books during the period that is most favourable for them, instead of the period that the GAAP advocate (Rosenfeld 2000).

A study, performed by Sweeney and Pierce (2011), showed that the ability to trust an audit might be complicated by the lack of skills in an inexperienced audit team. Sweeney and Pierce claim that inexperienced audit team members could increase the risk of not finding errors in the accounting since the auditee probably would have more knowledge about the business than the audit team would. The study also shows evidence that the auditor, to become more trustworthy, should consider making the audit less predictable to ensure that the auditee’s influence and amenability stay in balance and do not complicate the audit process.

However, an audit can also give credibility to the financial reporting of a company, which in turn can help the company to receive funding more easily than if the company had not been audited (Hope, Thomas & Vyas 2011). There is also evidence that non-audited companies pay significantly higher interest rates on their loans, which is why performing an audit could decrease the interest costs of a company (Kim, Simunic, Stein & Yi 2011)

### 3.5 Agency Theory

The Agency Theory focuses on the previously mentioned problem with information asymmetry that can arise between two parties. It discusses the situations where one person (the agent) has been delegated work by another person (the principal). The main problems that the Agency Theory discusses are: 1) the goals of the principal and the agent do not harmonise, and the principal cannot easily inspect what the agent actually is doing, and 2) the two parties have different views of risk and therefore the agent might take on or disregard situations where the principal would have acted differently (Eisenhardt 1989).

Jensen and Meckling (1976) are of the opinion that the relationship between the principal and the agent is complicated when the agent acts in his or her own interest instead of the principal's interest. To prevent such a situation, the principal could use incentives, such as offering shares or bonds in the company, to increase the chance of the agent acting as the principal prefers. According to Jensen and Meckling, monitoring by the principal could also be used as a method to ensure the performance of the agent. Jensen and Meckling (1976) also discuss the so-called bonding costs, which could be defined as costs paid by the agent to guarantee that he or she will act in the good of the principal. This includes external audit.

Another study, made by Shibata (2009), also shows that audit can redress the principal-agent problems that might arise between a company and an external party, in our study the Swedish Tax Authority. Shibata states that audit can reduce inefficiency in the relationship between the managers and the owners of a company. However, the study declares that this does not necessarily mean that audit can redress inefficiency in the social welfare. In an earlier study, Baron and Besanko (1984), came to the conclusion that a tax authority, by performing audits on companies, can increase the expected welfare and thereby the regulators would have a positive attitude towards these audits.

In our thesis, we will use a revised version of the Agency Theory where the Swedish LLCs act as agents and the Swedish Tax Authority is the principal. Between these two parties, information asymmetry might arise, as showed in the below picture, which we have created from our own interpretations of the information above.

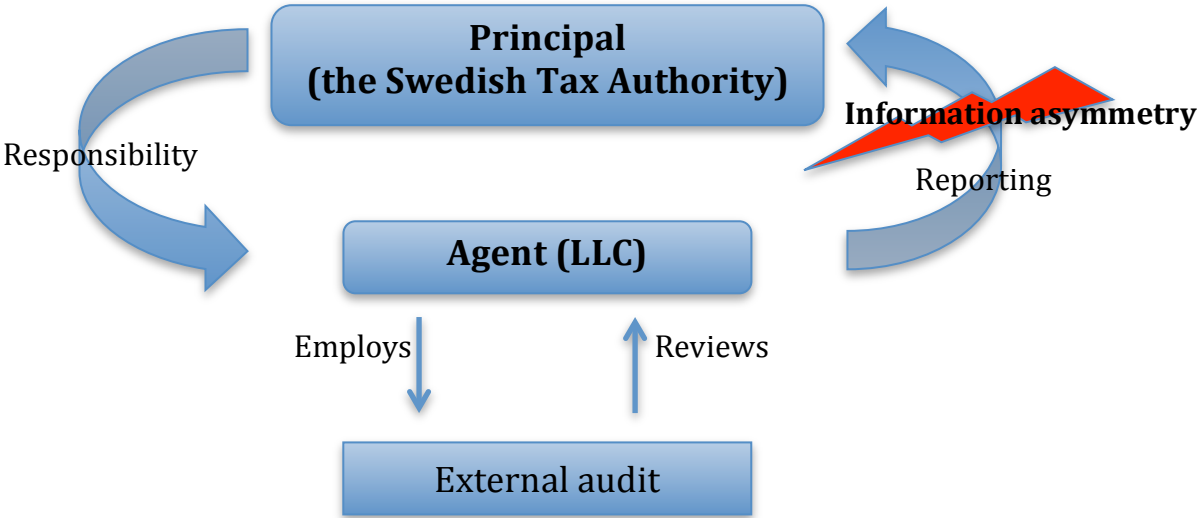


Figure 1. The authors' revised model of the Agency Theory.

In our revised version, the principal (the Swedish Tax Authority) gives the agents (the companies) the responsibility to report their earnings and thereby also the taxes they should pay. When the financial information is reported to the Swedish Tax Authority, an information asymmetry might arise concerning the correctness of the information: the company has more knowledge about its actual revenues and costs than the Swedish Tax Authority. An external audit could work as an assuring tool to ensure that the information is correct and thereby prevent the emerging of an information asymmetry.

### **3.5.1 The Relationship Between the Swedish Tax Authority and the Swedish Companies**

The Swedish Tax Authority is responsible for the collecting of taxes in Sweden. The collecting of taxes consists of mainly three parts; providing information, continuously handling cases and controlling. By informing companies and people about the taxation procedure and by working on cases throughout the financial year, the Swedish Tax Authority tries to work in a preventive way to decrease the errors that companies and people make while putting together their income returns. By screening the information, mainly the income returns, that the Swedish Tax Authority receives from companies and people, they also work in a controlling and monitoring way to ensure that there are no ambiguities or errors taking place in the companies' financial information (The Swedish Tax Authority 2013-b).

The Agency Theory, as mentioned earlier, often predicts that agency problems can be solved through a combination of three approaches. Jensen and Meckling (1976) specify these as: offering incentives to the agent, monitoring the agent or making the agent pay for the monitoring him- or herself (so-called bonding costs). For the Swedish Tax Authority, the incentive approach is hardly possible. Instead, the Swedish Tax Authority can, and does, use monitoring through performing tax audits and other controls, to ensure that the companies act as preferred by the Swedish Tax Authority. An external audit that the companies pay for themselves, is, from this perspective, viewed as bonding costs.

In Sweden, there are more than one million companies (Ekonomifakta 2012). The Swedish Tax Authority, as a principal, therefore needs to monitor a large number of agents – all of the Swedish companies that are bound to render taxes – to ensure that no irregularities ever take place. It might be complicated for the Swedish Tax Authority to scrutinise all of the agents; it would not be economically sustainable to do so because of the large number of tax audits that would need to be made (Ross 1973).

## **3.6 Tax Compliance**

The Swedish Tax Authority's vision is a community where all the people want to comply and do the right thing (The Swedish Tax Authority 2013-a). Eichfelder and Kegels (2012) studied data regarding Belgian companies' tax compliance burden, from the years 2000, 2002, 2004 and 2006. They concluded that customer-unfriendly tax administration could increase the companies' tax compliance burden, the time effort of employees and the expenses for external help and for information spent on tax compliance, by 27 per cent. Also, they found the most efficient aid from the tax authority to be that helpful information is provided in a timely manner, more so than the facility in contacting the authority (Eichfelder and Kegels 2012).

A study from 2010 investigated the relationship between tax evasion and self-reported or third-party reported income. An example of self-reported income is self-employment income while the third-party reported income includes wages, interest income and mortgage

payments. Business income is rarely reported from a third-party, but out of all Danish income about 95 per cent is third-party reported (Jacobsen Kleven et al. 2011).

One of the results of the study was that the tax evasion rate was only 0.3 per cent for income reported from a third party, while it was a staggering 37 per cent for the self-reported income. However, with the self-reported income only adding up to 5 per cent of the total income, the overall evasion rate is low (Jacobsen Kleven et al. 2011).

### **3.7 Denmark, Finland and England and their Experience**

Most of the other countries in the European Union have chosen to exploit the exemption stated in the Fourth Council Directive (SOU 2008:32). Denmark abrogated the statutory audit for small companies in March 2006 (Grant Thornton 2013), and Finland in July 2007 (SOU 2008:32), while England started the process to remove the statutory audit as early as 1994 and has later expanded the exemption to include more companies (SOU 2008:32).

In 2010, before the abrogation was realised in Sweden, Joakim Rehn, a board member at Grant Thornton in Finland and previous member of the IFAC council, reflected on why the Nordic countries were some of the last EU member states to adopt the abrogation possibilities. He thought that this could be due to that the Nordic countries have a tradition where the companies' annual accounts are the basis of taxation (Lennartsson 2010-a).

#### **3.7.1 Effects of the Abrogation of the Statutory Audits in Denmark, Finland and England**

England, Denmark and Finland, which abrogated the statutory audit in 1994, 2006 and 2007, have later increased the threshold levels, or planned to do so, and today England use the highest levels permitted by the EU's Fourth Council Directive. They have all supplemented the legislative changes with a possibility for a company's minority owners to request that the company should undergo an audit, in order to protect their interests (SOU 2008:32).

The main reason for an abrogation of the statutory audit, in all three countries, was that it would decrease the costs of the smallest companies and thereby make them more competitive (SOU 2008:32). Both Denmark and Finland discussed the principal-agent problems, which external audit tries to solve, and argued that it was not an issue in most of the smaller companies since the manager and the owner are often the same person (SOU 2008:32). Also, in Finland, the companies that would be exempted only amounted to a non-significant part of the total net sales and total corporation taxes that were generated by all of the companies (SOU 2008:32).

The tax authorities in the countries had different attitudes towards the external audit. The Danish Ministry of Taxation planned to perform more random sample controls to outweigh the possibly negative effects of the abrogation (SOU 2008:32). According to an article by Lennartsson (2010-b), they also experienced an increase in errors in the tax returns from the companies that had not undergone an audit. However, the Danish Ministry of Taxation was of the opinion that it was only a minor increase and they stated that the economic crimes had not increased at all (Lennartsson 2010-b). To further decrease the risk for possibly negative effects of the abrogation, the Danish Business Authority was given the possibility to impose audit on companies where the owner had violated the accounting regulations, the corporate regulations or the taxation regulations (SOU 2008:32). The Danish government also extended the obligation for the auditors to give notice when they suspected that someone in the company's management had engaged in economic crime (SOU 2008:32).

Before the legislative changes, the Tax Administration in Finland was of the opinion that the external audit did not give much value concerning the taxation. However, they still believed that the number of tax inspections would need to be increased (SOU 2008:32). Their English counterpart, HM Revenue and Customs (HMRC), declared that the choice not to have an external auditor would not lead to a higher risk for the companies of being reviewed by the HMRC (SOU 2008:32). The HMRC stated that it was of greater importance whether the company had hired someone to establish the accounting or not and who had signed the tax returns, than that the company had been audited (SOU 2008:32).

Between the years 2008 and 2012, four researchers performed a study on a random sample of 412 small Finnish companies. The study indicated that a company is more likely to hire an external auditor when it is experiencing financial distress. Reversely, the likelihood of hiring an auditor is reduced when there is a supply of competitive external tax advisory services, at least in an environment where the financial reports are the main basis of taxation. Also, a company that has priorly received a qualified audit report may be less willing to hire an auditor in the future (Niemi et al. 2012).

In England, other, less extensive, quality controls that the companies can choose to undergo have been implemented. One of the most commonly used today is called the *compilation report*. A compilation report can be done by anyone and there are no guidelines that need to be followed. The report is mainly of interest to the company's management. Because of the lack of guidelines and professional requirements, the report has been highly criticised and in 2006, the so-called *assurance service* was introduced by the audit association ICAEW. The purpose of this report is to act as a mixture between an audit and a compilation report. The assurance service can only be performed by the so-called *chartered accountants*, imposing higher demands on the person who performs the control (SOU 2008:32).

## **4. EMPIRICAL FINDINGS**

The empirical findings, from the interviews that we have held, are compiled and compared in this chapter. The interviews with the employees at the Swedish Tax Authority will be presented first and thereafter we will present the interview with the employee at the Swedish Companies Registration Office.

### **4.1 Interviews with the Employees at the Swedish Tax Authority**

The interviews have been performed with five employees from different departments at the Swedish Tax Authority. We have interviewed Kerstin Lundgren, a business developer who has been involved in the work surrounding the legislative change. We have also interviewed Fredric Brolin, head of one of the audit sections. Furthermore, we have performed an interview with Alf Oskarsson, a tax auditor and project leader who works mainly with the registry of company information. Thereafter, we interviewed Linda Hedenvi, who works as a tax official, mainly focusing on small, newly established companies. Finally, we interviewed Maria Berglund, a tax auditor focusing on organised crime.

The interviews have shown some consensus within the authority. Overall, they are now positive to the legislative change. The main opinions are that the external audit is not of great help to the Swedish Tax Authority and that the new tool that they have been given, the General Accounting Controls, is more efficient than the external audit in most situations. The main reason for this is that the General Accounting Controls can be made as a preventive measure, while the external audits, as well as the tax audits, are made in retrospect. The General Accounting Controls is perceived to be a more efficient tool to evaluate the quality bookkeeping.

#### **4.1.1 The Value of the External Audit**

The opinions of the external audit differ among the employees. Brolin experiences that the external audit can work well, but that it depends on how the auditor chooses to work. He believes that an external auditor that is in close contact with the company is more likely to perform a trustworthy audit of the company. However, he emphasises that a close relationship between the auditor and the auditee could lead to an independence issue for the auditor, who runs the risk of performing an untrustworthy audit. He also stresses the fact that the external auditor reviews the company in retrospect and thereby risks being unable to discover severe errors in time. Lundgren, on the other hand, does not find the external audit particularly useful for the Swedish Tax Authority. She finds the external audit rather unnecessary for the smaller companies, since they rarely meet with the external auditor more than once a year and thereby the external auditor does not have insight into the continuous operation of the company.

Hedenvi brings up the same issue as Lundgren and she also stresses the fact that the external auditor does not know the company particularly well because of how they work. Nevertheless, she considers the external audit to be some sort of a quality assurance and believes that many companies share this view, as well as external stakeholders, such as banks. She herself has earlier worked as an accounting consultant, hired to help companies with their accounting, and she says that she appreciated the possibility to have another person, an external auditor, to review her work. She also feels that an audited company is somehow more



reliable and that an external audit could give a signal as to whether everything is right or not in the company. However, she adds, it is hard for an external auditor to discover the persons that want to cheat the system, since they are often very good at this and thereby might also cheat the auditor.

Berglund also addresses the issue that external auditors normally do not review all of the material and might not find unintentional errors or hidden irregularities. Nevertheless, she thinks that the external audit is a quality assurance and that it might be of more importance to a smaller company, since it has rarely developed internal controls in the same manner as the larger companies. The fact that not all material is reviewed by an external auditor is also brought to the table by Oskarsson. He thinks that the absence of an auditor might have increased the risk for economic crime, but accentuates that many of the people who want to cheat will try to cheat the auditor as well. However, he sees the external audit as a benefit since he is of the opinion that one more review could decrease the risk that something is wrong.

#### **4.1.2 The Swedish Tax Authority's View on Accounting Consultants**

Some small businesses do not have the relevant knowledge in-house to perform the bookkeeping and could benefit more from focusing on the core business activity instead. Hedenvi believes that the errors in the small LLCs' annual statements are mostly caused by a lack of knowledge and ignorance.

An external accountant is present throughout the year and performs the continuous bookkeeping, while an external auditor often only comes in once a year. The general opinion among the interview objects is that a continuous contact with the company is an advantage. The accounting consultants have recently received more assignments and responsibilities; certifications have been invented to improve their standing.

The interview objects think that it is more useful for a small LLC to contract some form of external help with the bookkeeping and annual accounts, than to perform these functions themselves and only hire an external auditor. Oskarsson believes that although there were entrepreneurs that did not have external help from a bookkeeping agency or an accounting consultant before the legislative change either, at least then they had an external auditor, who was supposed to check their work and redress both the intentional and the unintentional errors.

The interviewees agree that the information that the entrepreneurs indicate on the tax return regarding whether the company has had external help with the bookkeeping or not, is not used as a selection criterion. Brolin thinks that this could be a possibility in the future, but makes a reservation regarding the importance of *who* has helped - whether it is a certified accountant or someone else.

#### **4.1.3 The Benefits of the General Accounting Controls**

The General Accounting Controls is a welcomed tool for the Swedish Tax Authority, according to the interview objects. However, many stress that these controls are not yet fully developed and that they could be used more than they are today. Oskarsson believes that they can act as a less intimidating tool than the tax audits. Nevertheless, he emphasises that the General Accounting Controls should be used carefully while handling suspected economic crime since they might risk that the reviewed company understands that it is being monitored and this might complicate an ongoing investigation.

Brolin appreciates the opportunity for the Swedish Tax Authority to work in a more preventive manner and the possibility to help the companies to report correct information. Lundgren also has a positive attitude to the General Accounting Controls and finds them important, since they enable the Swedish Tax Authority to investigate whether companies will be able to report correct information rather than review the information in retrospect. She mainly appreciates the possibility to discover errors in time and especially points out the unintended errors that arise because of lack of knowledge. Her experience is that the companies that have been reviewed also appreciate this possibility to meet with the Swedish Tax Authority under less formal conditions. Lundgren further believes that the General Accounting Controls will be used more frequently in the future, since they are less expensive for the Swedish Tax Authority and not as demanding for the companies as a tax audit can be.

Berglund and Hedenvi also find the preventive function of the General Accounting Controls very useful to the Swedish Tax Authority. Hedenvi believes that they could be used to investigate whether suspicions concerning a company are correct or not, since it gives the Swedish Tax Authority the possibility to review the book-keeping for just a few months instead of the entire fiscal year of a company. She, like Oskarsson, finds the controls less intimidating for the companies than a tax audit and appreciates the opportunity to perform a smaller review of a company. Nevertheless, she accentuates that the new tool requires that the person who do the controls has knowledge in accounting in order to be able to perform a valuable review.

Hedenvi also accentuates the possibility for the companies to refuse to meet with the Swedish Tax Authority; the companies can say no to this less comprehensive review. However, she has not yet met a company that has not been interested in meeting with them. Nevertheless, she thinks that the General Accounting Controls can be developed and be used even more. She feels that sometimes they want to investigate something further, which is not possible today, and therefore she would want to develop this part of the General Accounting Controls so that they can be even more effective.

Hedenvi finds the preventive actions increasingly important to the Swedish Tax Authority and stresses that their vision, a community where everyone wants to comply and do the right thing, is hardly possible if the Swedish Tax Authority only works in a controlling way. She believes that the Swedish Tax Authority will use the General Accounting Controls more and give even more information in the future. Hedenvi is of the opinion that if they can reduce the smaller errors, which are made unintentionally, by providing information, the Swedish Tax Authority can focus more on detecting those who do not intend to engage in fair business activity.

#### **4.1.4 The Swedish Tax Authority - from Control to Service**

Many of the interview objects emphasise that the Swedish Tax Authority today focuses more on giving information than earlier. For example, they have started a co-operation with The Swedish Companies Registration Office and the Swedish Agency for Economic and Regional Growth, through the website *verksam.se*, with the ambition to increase their presence among the entrepreneurs.

The General Accounting Controls is also viewed as a type of information provision, since its aim is to increase the chance of companies having correct accounting. Nevertheless, the interview objects also stress that the Swedish Tax Authority is, and always will be, a controlling authority. Lundgren is of the opinion that the Swedish Tax Authority now rather views the business environment from the companies' perspective; that it is important to give

advice and support to those who try to operate an honest company. In her experience, the attitude towards the Swedish Tax Authority has also changed, in that they have an increased supporting and helping role in society today. However, she brings up that they need to regard how much help they are able to give, since they cannot be involved in tax consultancy.

Oskarsson and Berglund consider the control function to be more important than the informative function, since they work with companies that make intentional errors. Oskarsson emphasises that it is important to have a good relationship with the companies, but also that it is hard to accomplish such a relationship with those who want to engage in economic crime. Brolin supports these opinions and believes that it is hardly possible to redress economic crime with information. He rather finds the control function suitable to unravel economic crime. However, his experience is that the Swedish Tax Authority, in order to achieve their mission to cut the total tax error in half, cannot only use their control function, since it is highly resource demanding. Instead, he believes that the Swedish Tax Authority should combine the control functions with providing information in order to redress the intentional as well as the unintentional errors. Brolin perceives that the companies request more information and refers to the information meetings that the Swedish Tax Authority holds, which often fill up quickly. He finds these information meetings helpful to the Swedish Tax Authority, since they increase the probability that the companies report correct information and thereby lessen the workload of the Swedish Tax Authority. He further mentions that the Swedish Tax Authority, during the past year, has started to review public procurements in order to ensure that only honest companies participate.

Hedenvi emphasises that the Swedish Tax Authority still is a mainly controlling authority and also that the informative function is rather new to them and therefore it will take some time before it is highly effective. However, she thinks that they are on their way to becoming more supportive for the companies and that reaching out to help the newly established companies will decrease the total tax error in the long run.

#### **4.1.5 The Transition**

There was a great deal of discussion at the Swedish Tax Authority right after the legislative change, but now it has subsided and they have realised that their fears, expressed in the statement of opinion, probably were overstated. There is still some discussion going on at the department for economic crimes though. Most of the small LLCs that the department deals with have dismissed the external auditor when given the possibility and Berglund thinks that it is possible that the risk of economic crimes now has increased.

Brolin, however, is not under the impression that the errors in the tax returns have increased since the abrogation, nor does he believe that there is an increased risk of economic crime. He believes that the companies that consciously evade taxes find a way to do so, regardless of whether there is a statutory audit or not. Earlier, the dishonest persons were able to select another company form that does not require that the annual statement is audited. He does not see any obvious implications of companies that used to have an external auditor now switching to bring in external book-keeping help and believes that the companies that wish to evade taxes use neither of those. He does not think that the non-audited companies will be reviewed more carefully than the audited companies. Some of the other interviewees consider the fact that a company has been audited as one of many parameters that affect whether a company should be reviewed or not, but most of them consider this parameter to be less important than the other parameters that are taken into consideration.

Oskarsson believes that it is more likely for a newly established business to choose not to employ an external auditor, than for a business, that was active before the legislative change, to make the active decision to disengage the auditor and make the change to the articles of association. Among the reasons for this, he states that a company develops a relationship with its auditor and this person can act as a safety and a comfort for the entrepreneur. The external audit is an additional cost, but possibly not a large burden in the big picture.

Hedenvi is worried that there are proprietorships that were attracted to the incorporated company form when the simplifications were realised and thus changed, without being fully aware of the regulatory framework that follows. In her experience, there are entrepreneurs who have misunderstood the concept and now believe that they do not even have to submit the annual statement. She values the external accounting help for companies and estimates that 70 per cent of the Swedish corporations now enlist an accounting consultant or suchlike.

#### **4.1.6 Opinions Regarding Future Developments**

The interview objects agree that the current threshold levels are adequate and Lundgren likens the small LLCs to the proprietorships, many of which would not attain these threshold levels. The Swedish Tax Authority is open to developments, after further evaluations have taken place. Brolin is not sure whether an abrogation of the statutory audit for larger companies would have a substantive effect, since most of them have a department that focuses solely on these functions and does so successfully. Nevertheless, he believes that the external audit might work better for a larger company since the audit team then must be more involved in the daily operations to be able to perform an audit of high quality. Hedenvi believes that a smaller company carries a smaller risk of errors than a larger one and thus it is possible that it suffices to have only the external accounting help, while the annual statements of the larger corporations still require the external audit.

Oskarsson makes a reservation regarding the threshold levels, that there is a time lapse that can be utilised in economic crime. A company has to attain at least two of the threshold levels for two consecutive years, before it needs to appoint an external auditor. Before this period has elapsed, criminals have probably transferred the business and its resources to a new corporation and started on a new time period of two years. He says that if then there is a value in the external audit, society would be a step behind in these situations. There could be other reasons for the transfer than economic crime however, such as when the new generation takes over a business.

Another issue brought up in the interviews is the fact that it is the company's board of directors' task to acknowledge when the company fulfils the criteria for mandatory audit and thus needs to employ an external auditor. In other words, in a small LLC, this question should then be discussed among a few (or even only one) persons, a procedure that the interview objects question.

All five interview objects agree that it is better today, with the General Accounting Controls, than before the abrogation. Lundgren states that they have not yet seen all the benefits of the change and that they are still learning to utilise the possibilities to their full potential. Hedenvi is open to the possibility of further simplifications with less formalities for the small LLCs, but emphasises the annual statements' benefits: it is the company's facade, the entrepreneurs should learn how to use them.

However, Berglund does make a reservation that the abrogation could prove to be a greater disadvantage for the department for economic crimes at the Swedish Tax Authority; maybe they would prefer to later reinstate the statutory audit for all corporations.

## **4.2 Interview with an Employee at the Swedish Companies Registration Office**

We have interviewed Per Nordström, the Chief Legal Officer at the Swedish Companies Registration Office. This interview focused on the quality of the annual statements of the companies that have been exempted from the statutory audit, information that could be helpful for the understanding of how the Swedish Tax Authority might have been affected by the removal of the statutory audit. A change in the quality of the accounting might have led to a change in the quality of the basis of taxation. Thereby, we might be able to draw conclusions about how the taxation might have developed. During the interview we also received some statistics regarding the defects in companies' annual statements.

### **4.2.1 The Abrogation of the External Audit for Small LLCs**

Nordström started the interview by making a reservation regarding the visible changes since 2010: a short time before the abrogation of the statutory audit, the capital stock requirement for starting an LLC was lowered. Thus, it is hard to isolate the effects coming specifically from the abrogation. Normally, approximately 20 000 LLCs are established each year, but after these changes the number rose to around 45 000 a year. However, in 2012, it sank to 39 200.

Nordström states that there is a large increase in delays in the companies' submission of annual statements, but also that this has, in part, been redressed by penalty fees. The Swedish Companies Registration Office receives approximately 3 000 telephone calls daily, which is a large increase since before the legislative change. Nordström assumes that the questions that entrepreneurs earlier chose to pose to their external auditor are now addressed to them instead. He is worried that some of the companies that have chosen not to have an external auditor do not have external help with the bookkeeping either, nor the relevant knowledge to perform it themselves.

Beyond these questions, many calls regard changes to the companies' articles of association, from the companies that no longer wish to use an external auditor. The Swedish Companies Registration Office recommend the entrepreneurs to enter a regulation that states that the company should not have an auditor, but if the annual meeting so decides, an auditor can be appointed after all. However complicated this arrangement may be, there is a practical reason: to make a change in the articles of association requires a qualified majority of two thirds, while the decision to appoint an auditor (when the aforementioned regulation has been entered) only requires a simple majority (more than half of the votes).

### **4.2.2 The Value of the External Audit**

Nordström is very concerned by the decline in the quality of the annual statements that no longer go through an external audit. He stresses the importance of an external auditor's competence and the fact that he or she is authorised by the Supervisory Board of Public Accountants.

However, Nordström assumes that some entrepreneurs, incorrectly, believe that if they do not employ an external auditor their tax returns will be more severely monitored by the tax officials. Also, that some are afraid their creditworthiness would be lower in the absence of the external auditor. Nevertheless, he does not believe the auditor's role as an intermediary between the board and the owners to be important in a small LLC. These two parties are often

the same persons in a small LLC, so if criminal activity were to occur, it would hardly be likely that the owner reports it him- or herself.

Several years ago, the Swedish Companies Registration Office evaluated the possibility to enter into the registry whether a company has received qualified audit reports. This proposition was disregarded, since they were worried that it could result in a small formality that causes a qualified audit report resulting in a much larger issue when only appearing as a mark in the registry.

Regarding the defects in the annual statements that they receive from companies, there has been a large overall increase. However, when compared to the increase in number of companies, there are only regular yearly movements. When looking at specific areas, the evident increases are in the formality errors. For example, in 2012 the Swedish Companies Registration Office received 14 per cent more annual statements compared to 2010. Out of these, close to 0.77 per cent had not been signed by the board of directors and the CEO, while in 2010 there were only 0.35 per cent of the annual statements that lacked the signatures.

While these seem to be minor changes, with a total of 326 383 annual statements in 2010 and 371 380 in 2012, in absolute numbers the increase was from 1 110 to 2 869. This pattern also shows in other formalities and Nordström believes that the absence of the external auditor in some LLCs is a contributing factor to these degradations.

#### **4.2.3 Views on Accounting consultants**

Nordström's experience is that the accounting consultants say that the legislative change is fruitless since they are the ones who have always made all the work. If that were true, the Swedish Companies Registration Office would still receive correct annual statements, which is not the case; as mentioned earlier, Nordström sees a decline in the quality.

However, he does see a value in the continuous contact between an accounting consultant and a company, especially in the small LLCs where the entrepreneurs sometimes do not have the relevant knowledge themselves.

In order to file the annual statement on time and in accordance with the legislation, as well as to avoid compulsory liquidation, Nordström believes that taking help from a bookkeeping agency or an accounting consultant is an advantage.

#### **4.2.4 The Swedish Companies Registration Office - from Control to Service**

Nordström believes that there has been a transition from the stringent monitoring to an increased service and information function at the Swedish Companies Registration Office. In co-operating with the other authorities at the website *verksam.se*, they are aiming at facilitating the situation for the entrepreneurs and making the services visible to them.

The Swedish Companies Registration Office also gives information meetings for entrepreneurs, especially those that do not have an external auditor. Nordström says that the entrepreneurs often look at what they can get from the authorities for free, before they seek external help. In the past, the Swedish Companies Registration Office has even held courses in bookkeeping, but not anymore since they believe it to not be their role and not within their responsibility.

## 4.2.5 The Transition

After the legislative change, approximately 72 per cent of the Swedish LLCs were able to choose not to have an external auditor and today 63 per cent of these LLCs have chosen to do so. It is mainly the businesses that were established after the change that have chosen to use the possibility; around 68 per cent of these do not have an external auditor. Nordström believes that some of the companies that were already active before the change, chose to keep the external auditor awaiting the reactions from their competitors and the financial markets.

If the Companies Registry at the end of the fiscal year states that a company has an external auditor, the company's annual statement will have to have an audit report attached to it. Although the transition rules stated that it was enough that the notification of dismissal of the auditor and a change to the articles of association had arrived at the Swedish Companies Registration Office before the end of the fiscal year, some companies made mistakes.

A company might have made the decision to dismiss the external auditor in November 2012, but the notification did not arrive until January 2013, in which case there needs to be an audit report. Then the annual statement arrives in June 2013 and the Swedish Companies Registration Office demands an audit report, but the company does not have one; it is complicated and Nordström and his colleagues have to handle many questions from the entrepreneurs regarding this. The entrepreneurs want to save money and do not understand why it has to be so complicated, but they have to follow the legislation.

Nordström believes that the transition rules have been generous - a company might have had the help of an external auditor until November 2012, but then dismissed him or her and notified the Swedish Companies Registration Office in December 2012, and then still not have to attach an audit report to the annual statement.

Nordström further believes that the cost burden has decreased for the small LLCs and that the important goal of displaying a good entrepreneurial climate has been achieved. He thinks that the entrepreneurs are pleased with the change, but stresses the importance that both the authorities and the private sector now help the companies to act correctly, despite the absence of an external auditor.

The Swedish Companies Registration Office does not control whether a company acts in accordance with the threshold levels, regarding the obligation to have an external auditor. It is not their responsibility to compare subsequent years to see whether a company fulfils at least two of the criteria for two consecutive years. If a company reaches the levels where an external audit is mandatory, it is the board of director's duty to appoint an auditor. Primarily, the Swedish Companies Registration Office has to rely on this, but the credit-reporting bureaus can sometimes also alert them. When they get an external indication regarding a company, they investigate the numbers and if the implications are true they will contact the company and tell them to hire an external auditor.

If the companies do not follow the protocol, the Swedish Companies Registration Office has a tool to liquidate the company, but they do not perform continuous checks. Nordström does not believe that they need another tool for this. They liquidate approximately 1 000 businesses every year.

Nordström also sees an issue with the current threshold levels; a start-up business that grows quickly and attain the threshold levels already in its first year will still not need to hire an external auditor until its third year of operation, before which a large number of things might have happened in the business.

#### **4.2.6 Opinions Regarding Future Developments**

During the development of the memorandum, much higher threshold values were proposed, even levels that would include as many as 98 per cent of the companies in Sweden. Nordström was against this and still is; he thinks the aforementioned shortages currently invalidate higher levels.



## 5. ANALYSIS

In the following chapter, we will analyse our empirical findings and relate them to our theoretical framework and literature review. Based on these findings, we have chosen three areas, which we will mainly focus on in our analysis; the perceived value of the external audit, the view on accounting consultants and the General Accounting Controls performed by the Swedish Tax Authority. The revised model of the Agency Theory, presented in the third chapter of this thesis, will be complemented with the tools for redressing the information asymmetry. Then, we will finish by analysing the development of the working processes at the Swedish Tax Authority as well as the transition and the future expectations regarding the statutory audit.

### 5.1 How to Redress the Information Asymmetry

The studies that have discussed the principal-agent problems argue that a principal, in order to redress the information asymmetry, should use either incentives or monitoring. The monitoring could be performed, and paid for, either by the principal him- or herself, or he or she could delegate this responsibility to the agent and make the agent pay for and do the monitoring.

For the Swedish Tax Authority, the provision of incentives is hardly possible. Usually, the incentives would consist of shares or bonds in the company or organisation that the principal has an interest in. Applied on our revised model of the Agency Theory, this means that the Swedish Tax Authority would have to offer shares or bonds in the Swedish State, so called government bonds. If the Swedish Tax Authority were to give Swedish government bonds to all companies that assess their taxes correctly, the Swedish Tax Authority would need to closely review every company to ensure that they actually had paid the right amount of taxes, which would not be economically sustainable according to Ross's (1973) study. This issue was also brought forward by the interview objects. Thus the incentive approach is not appropriate for the Swedish Tax Authority to redress the information asymmetry.

One might also question an incentive system in which the individual who has been given the incentive cannot explicitly influence whether the value of the bond will increase or not; the value of the government bonds are not directly dependent on whether the Swedish companies assess taxes correctly. In addition to this, it is questionable whether a tax system could include rewarding a taxpayer for the sole purpose of reporting the correct numbers, a mission that should be a given and not an achievement.

Remaining then is the monitoring approach, which is the approach that the Swedish Tax Authority uses today. Before the legislative change, concerning the statutory audit and the General Accounting Controls, the tax audits was the only tool that they could use to monitor the Swedish companies. The tax audits are often effective, but a disadvantage, according to the interviewees, is that they are highly resource demanding and usually strenuous for the reviewed company. They are also made in retrospect and many of our interview objects regard this as an additional disadvantage since it could increase the risk of not detecting errors on time.

After the legislative change, the Swedish Tax Authority was given a new tool to monitor the companies, the General Accounting Controls. These controls are less resource demanding and might therefore be used more frequently than the tax audits. The interview objects appreciate this new sort of monitoring and highlight the possibility to review more companies without

needing more resources. It was also of importance for the employees at the Swedish Tax Authority to be able to do continuous reviews of companies and detect errors early in order to decrease the risk of incorrect tax returns. Today, the Swedish Tax Authority can perform their monitoring through either of the two tools: the tax audits or the General Accounting Controls.

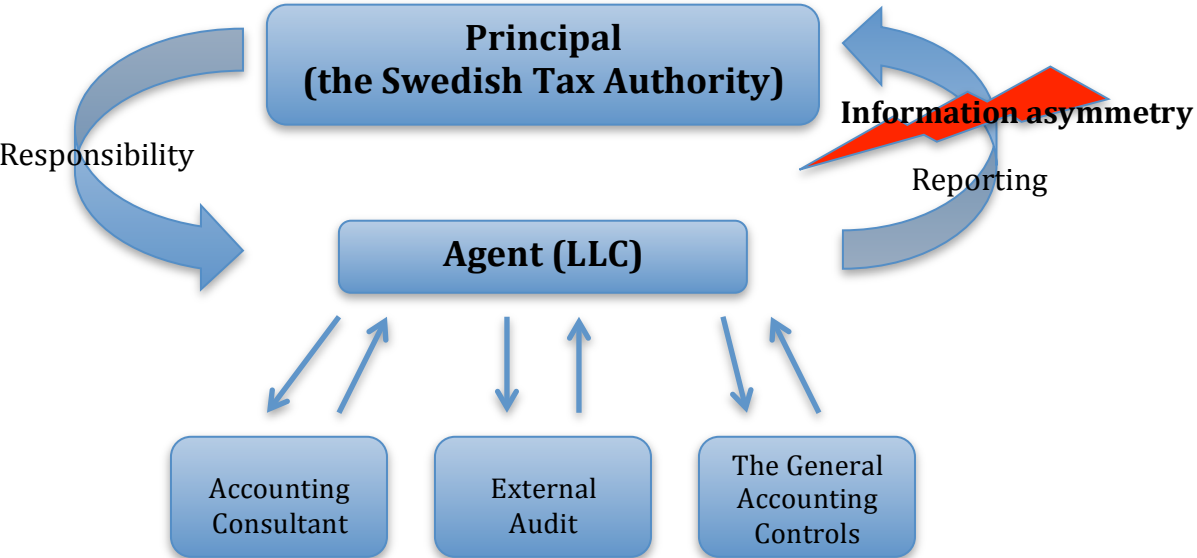
Earlier, the external audit was mandatory for all Swedish LLCs. Thereby, self-monitoring, originating in the external audit, occurred in all companies. After the abrogation of the statutory audit for the small LLCs, self-monitoring is no longer a possible instrument for the Swedish Tax Authority to ensure that the companies act correctly, since there is no guarantee that it is used by all of the companies.

Hence, the Swedish Tax Authority can only rely on the monitoring they do by themselves, through tax audits or General Accounting Controls, when it comes to redressing the information asymmetry between the Swedish Tax Authority and the small LLCs in Sweden.

## 5.2 The Abrogation of the Statutory Audit for Small LLCs

In general, the interview objects are positive to the legislative change and are of the opinion that the Swedish companies should be spared the cost of the external audit, like their foreign competitors. However, they see some sort of value in the external audit, but cannot specify how. Nevertheless, an additional review is considered a benefit.

Below is the previous model, which we have now complemented with two additional tools that might be able to redress the information asymmetry between the principal and the agent.



**Figure 2. The authors’ extended revised model of the Agency Theory.**

The three tools are: an accounting consultant, an external auditor and the General Accounting Controls. An accounting consultant, employed by the company, could redress the information asymmetry between the company and the Swedish Tax Authority, since the accounting consultant has the relevant accounting knowledge, and thereby could establish the accounting correctly. If the company instead chooses to employ an external auditor they will not receive help with establishing the accounting. Instead their accounting will be reviewed by the external auditor, who will ensure that the accounting is established correctly. The General

Accounting Controls are similar to the external audit, since it is an independent review of the company that ensures the correctness of the accounting. However, in contrast to the external audit, the General Accounting Controls are performed by the Swedish Tax Authority during the fiscal year, instead of at the end of the fiscal year, and the company does not pay for this review.

### **5.2.1 The Value of the External Audit**

Some of the small LLCs do still hire an external auditor, according to the Swedish Companies Registration Office's statistics, even though they are not obliged to do so. Thus, the Swedish Tax Authority can take into consideration that some monitoring is still made by the companies themselves. However, the interview objects do not consider the external audit to be sufficient to be able to ensure that the companies act according to legislation, since the external auditor sometimes only visits once a year. Nevertheless, they consider it to be a good help and a quality assurance for companies in the cases where the contact between the company and the external auditor is continuous and the external auditor does have relevant knowledge concerning the company. Knowledge about the company is also highlighted by Sweeney and Pierce (2011), who are concerned by the situations where the auditee has more knowledge about the business than the external auditor has.

Consequently, the external audit might be able to redress the information asymmetry if there is a close relationship between the external auditor and the company. However, it is important to remember that the external auditor still needs to be independent from the company and act objectively, in order to perform a trustworthy and valuable audit, which is brought to concern by some of the interview objects. This is also brought up by the definition of external audit used by FAR and there are other researchers, for example Doralt et al. (2012), who fear that unreliable audits could ultimately result in markets collapsing.

Many of the interviewed employees at the Swedish Tax Authority also state that the value of the external audit, as an assurance that the companies' financial information is correct, is complicated by the fact that the external audit, like the tax audit, is made in retrospect. There is fear among all of the interview objects that this condition compromises the possibility to detect errors in the accounting.

The interviewees agree that the external audit is not a disadvantage, but are not sure whether it is a significant advantage to them. Knutsson, Norberg and Thorell (2012) state that, although an audit is not a guarantee that the accounting is correct, it could contribute to an increased reliability of the information. One benefit of the external audit was brought forward in Maijoor and Vanstraelen's study (2006): a strict audit quality regime could decrease the possibilities for earnings management.

Most of the interview objects regard the external auditor as a not very good solution to detect economic crime since they do not review all of the material of the company, but rather review random samples of the business transactions. The main opinion among the interview objects is that the persons who want to cheat the system often cheat the external auditor as well. This makes us believe that the external audit might be more useful to detect and prevent unintentional errors, rather than intentional ones. Thereby, the external audit could prove to be more useful to redress the information asymmetry between the Swedish Tax Authority and a company that wants to act according to legislation, than between the Swedish Tax Authority and a company that wants to avoid taxes. However, the Swedish government's ambition, when they reformed the statutory audit to include the small LLCs, was to prevent economic crime from happening, which was an increasingly common issue that was most evident in the

small LLCs (SOU 2008:32). Berglund and Oskarsson see more advantages of the external auditor than their colleagues, but even though it does have a positive effect on the possibility to detect economic crime, there are other methods that work better today.

### **5.2.2 The Views on Accounting Consultants**

The interview objects value the appointing of an external accounting help higher than that of an external auditor, emphasizing the importance of a continuous presence in the company. Also, they stress the importance of the external help, including the auditor, establishing a relationship with the company. However, the interviewees do not believe that the small LLCs that earlier only had the help of an auditor, and now are exempted from the statutory audit, are particularly likely to have switched to hiring external accounting help instead. They fear that the unintentional errors increase when a company does not contract either form of external help. Also, when an external party is involved in the reporting of income, the possibilities for intentional errors could decrease. Jacobsen Kleven et al.'s study (2011), regarding income reporting in Denmark, showed that tax evasion was more common in self-reported income than in third-party reported income. If an external party were to perform a company's bookkeeping and thus assist in the calculation of the company's income, the risk of tax evasion could be decreased.

The risk that companies lack the competence to establish their accounting and annual statements could be decreased by hiring an accounting consultant, according to some of the interview objects. This would also increase the reliability of the companies' financial information and decrease the risk for asymmetrical information, which is discussed in the theory on "Market for Lemons" (Akerlof 1970). However, the Swedish Companies Registration Office experiences that the accounting consultants might not always have the same knowledge of how to establish the annual statements, and especially the formalities that concern them, as the external auditors have.

On the other hand, Graner, in the recent interview by Lennartsson (2013), indicated that they are trying to simplify the establishment of annual statements and tax returns for small LLCs. If the formalities regarding this process were to decrease and the external auditor's role in fact mainly is to check these, the need for an auditor in a small LLC could decrease even further.

An accounting consultant is sometimes perceived to have more knowledge about the company than an external auditor, which could resolve the issue brought forward by Sweeney and Pierce (2011), namely that audit teams sometimes lack the relevant knowledge about the business.

Nevertheless, the interviewees all make a reservation regarding *who* is hired to perform the bookkeeping. An accounting consultant that is approved by The Association of Swedish Accounting Consultants induces confidence and the certification should be valid proof of their knowledge. With the relatively strong relationship between accounting and taxation in Sweden and the added assurance that an accounting consultant might bring to the table, this could result in fewer errors in the tax returns.

### **5.2.3 The Benefits of the General Accounting Controls**

The interviewed employees at the Swedish Tax Authority consider the General Accounting Controls to be beneficial for their operations and appreciate the advantages of a preventive work method as an addition to the other available functions. Especially the newly established companies and the small LLCs, where there is often a lack of the necessary knowledge to

perform the bookkeeping and to outline the income returns, run a greater risk of unintentional errors. The importance of providing information in a preventive manner is also stressed by Eichfelder and Kegels (2012), and therefore one might believe that the General Accounting Controls will be of great value to the Swedish Tax Authority in the future as well.

This tool is still under development and the Swedish Tax Authority believes that the application of it will widen in the future. In comparison, audit firms in England have implemented less extensive reviews. Maybe the Swedish Tax Authority will develop a mix between the tax audits and the General Accounting Controls in the future to optimise their monitoring function.

Regarding the General Accounting Controls, the interviewees also appreciate the possibility to continuously do reviews and support the companies. These controls are used to do reviews of existing accounting, but also to evaluate whether the company is able to establish correct tax returns. However, it is important that the person who reviews the company has sufficient knowledge in general accounting and about the business, an issue that was brought up by some of the interviewed employees and is shared by Sweeney and Pierce (2011).

The General Accounting Controls are considered to be less strenuous and less resource demanding for the reviewed companies as well as the Swedish Tax Authority. When the General Accounting Controls are used instead of the tax audits, the Swedish Tax Authority is able to perform a larger number of reviews, which could redress the issue with the economic sustainability of the scrutinising tax audits, brought forward by Ross (1973), among others.

### **5.3 The Authorities' Shift from a Control to a Service function**

Both the employees at the Swedish Tax Authority and Per Nordström believe that the two authorities have shifted towards a more service-minded attitude. In co-operating with other actors, such as the Swedish Agency for Economic and Regional Growth through *verksam.se*, they are making the information and their services more visible to the entrepreneurs. The interview objects all agree that it is more pleasant to approach the entrepreneurs with the ambition to *serve* them rather than to *control* them. Eichfelder and Kegels (2012) have shown that more customer-friendly tax administration decreases the tax compliance burden for the companies.

Through this open attitude, the Swedish Tax Authority hopes that the entrepreneurs will have a positive attitude to them and the monitoring that they perform. The interview objects all emphasise the fact that the authorities' main function still is to control the businesses, but also that the different methods for providing information is an important part of this. In order to ensure that the companies act according to legislation, the interviewees stress that the Swedish Tax Authority must provide the companies with information that enables them to do so. Again, it is relevant to refer to the conclusion by Eichfelder and Kegels (2012) that a more supportive approach is more effective for increasing the tax compliance. However, the service-minded approach might only be able to redress unintentional errors, according to the interviewees' experiences, and consequently a controlling approach will still be needed in order to be able to detect economic crime and intentional tax avoidance.

When the authorities provide the entrepreneurs with the relevant information, they too could become more willing to provide correct information in the exchange regarding their business. This could imply that the information asymmetry between the Swedish Tax Authority and the reporting companies decreases.

## **5.4 The Transition**

It is possible to deduce that the interviewees that work with economic crime to some extent have a more conservative attitude to the external audit and believe that, even though it is not profoundly valuable for the Swedish Tax Authority, it is an additional review of the companies. Some of the interviewees even consider the risk of economic crime to have increased since the legislative change. This does not correspond with the Danish experience of the abrogation of the statutory audit, since the Danish Ministry of Taxation regarded the risk for economic crime to be unchanged.

Regarding which companies are to be reviewed, the interviewees have mixed opinions whether the non-audited companies should be reviewed more intensely than the audited companies. Most of the interview objects consider an audited company as equally likely to become reviewed as a non-audited company, which is consistent with the HMRC's view in England; they are more concerned whether the company has hired someone to establish the accounting or not.

Throughout the interviews, the general opinion seems to be that the abrogation of the statutory audit might not have affected the Swedish Tax Authority as much as the possibility to do continuous reviews of the companies, namely the General Accounting Controls.

## **5.5 Opinions Regarding Future Developments**

While discussing future developments for the statutory audit, the main opinion among the interviewees is that the threshold levels are appropriate for the time being and that an evaluation that considers all benefits and disadvantages should be made before the thresholds can be developed. However, many believe that the thresholds will be expanded to include more companies in the future. Some of the interview objects refer to the possibility that this would affect the total tax error less than the abrogation of the statutory audit for small LLCs would, since larger companies often have the competence to conduct the accounting correctly themselves. Nevertheless, the large companies might need an independent review of their internal controls, and therefore a statutory audit for the large companies might be valuable.

There are mixed opinions of whether the external audit is the most valuable to the small or the large companies. Some of the interview objects regard the external audit as being more valuable as a quality assurance for small companies, since they often lack the competence to do the accounting correctly themselves. Thus, it might be valuable for the small LLCs, which are now exempted from the statutory audit, to have an external auditor to review them. Other interview objects believe that the large companies run a higher risk of making errors, since they have more business transactions than a small company, and thereby it would be more valuable to ensure that these business transactions are reported correctly. Brought to question here as well is the continuous contact, which is regarded as occurring more often in the large companies and consequently the external audit would be more valuable to large companies.

A possible expansion of the threshold levels could induce the risk of a less trustworthy business environment, since the results of the studies performed by Dedman and Kausar (2012) and Knutsson, Norberg and Thorell (2012), imply that an external audit does increase the reliability of the companies' financial information.

An additional outcome is that the more companies that are exempted, the higher the risk for earnings management since there will be a less strict audit regime (Maijoor and Vanstraelen 2011). However, an extended exemption from the statutory audit could lead to a development

of other existing reviews that can be performed in order to ensure that companies act according to legislation. Many of the interviewees discussed the possibility of developing the General Accounting Controls, while results from England show that it is rather the external reviews that have been developed and refined, examples are the *compilation report* and the *assurance service* (SOU 2008:32). Maybe Sweden will develop less extensive external reviews as well.

Furthermore, some interview objects mention the issues with the application of the threshold levels. Firstly, there is no actual continuous control whether the LLCs that are exempted from the statutory audit later attain the threshold levels and thus need to employ an external auditor. Also, there is the time lapse where a newly established LLC will not need to employ an auditor until the third year of operation at the earliest, even though the business might have boomed long before that, a possibility that could be utilised in economic crime. The application process will probably need to be developed in order to address these issues.

It will also be interesting to see whether it will become more complicated for non-audited companies to receive funding, which has been implicated by Hope, Thomas and Vyas (2011). Some of the interviewees consider the external audit to be valuable to external stakeholders, such as banks, and Kim, Simunic, Stein and Yi (2011) also show proof that non-audited companies pay higher interest rates. This could indicate that even if the abrogation of the statutory audit were to be expanded to involve more companies, many companies would choose to keep their auditor in order to facilitate the funding.

# 6. CONCLUSION

In this part of our thesis, we will draw conclusions based on the analysis of the empirical findings that we have made and aim at answering our research questions. Lastly, we will make suggestions for future research areas.

## 6.1 The Research Questions

- How has the abrogation of the statutory audit for small LLCs affected the Swedish Tax Authority?
- Is the external audit useful to redress the information asymmetry between the Swedish Tax Authority and the Swedish companies?

## 6.2 Conclusion

The interviewees at the Swedish Tax Authority are positive towards the legislative change, mainly because of the new tool that they have been provided with. They seem to consider the advantages of the abrogation of the statutory audit for small LLCs to be more important than the possible losses in their monitoring function. However, they can no longer rely on companies having been reviewed by or having received help from someone with accounting competence.

Even though an additional review is not a disadvantage, the actual abrogation of the statutory audit has not significantly affected the Swedish Tax Authority since the external audit does not affect their processes as much as we thought. Another element of the legislative change, the General Accounting Controls, has affected the Swedish Tax Authority more than the abrogation.

The General Accounting Controls are a new possibility for the Swedish Tax Authority to review the companies throughout the fiscal year, which has facilitated their process of discovering intentional as well as unintentional errors on time. The external audit might be more valuable to redress information asymmetry that has arisen because of unintentional errors rather than intentional ones, since the intentional errors are often hidden and the external auditor only reviews samples to ensure the correctness of the accounting.

In order to redress the unintentional errors, the LLCs need to have the right knowledge to perform the accounting correctly, and therefore the continuous contact made possible by an accounting consultant, or the like, is beneficial. Regarding the intentional errors and economic crime, the Swedish Tax Authority considers the tax audit and other authority controls to be the best alternatives.

Comparing the external auditor to the accounting consultant, the latter might be more appropriate to ensure the validity of the continuous accounting while the former usually has a better knowledge of the formalities regarding the annual statement. In this thesis, both advantages and disadvantages have been brought forward, regarding these two functions as well as the third monitoring tool - the General Accounting Controls. Our results show strong advantages of employing external help, in any of the above-mentioned forms, for the purpose of decreasing tax evasion and errors. Thus objectivity seems to be a key factor.



A disadvantage of the external audit is that it is a process made in retrospect and consequently the accounting consultant and the General Accounting Controls are better to redress the information asymmetry since the errors will be detected on time.

The first country among the EU member states to exempt the small LLCs from the statutory audit, England, has developed other, less extensive external reviews of companies. These advances could indicate that there is a demand for these external and independent reviews and possibly that the external audit is in higher demand than it seems. The monitoring functions need to be adapted to the current business environment.

### **6.3 Suggestions for Future Research**

In this study, we have focused on one stakeholder, the Swedish Tax Authority, and consequently there are still many areas to study with regard to the abrogation of the statutory audit, some of which have already been studied. However, below, we will give a few proposals for future research that mainly relate to our specific area. We believe that the Swedish Tax Authority is an area where there is a great deal of potential for research.

It would be interesting to study how the General Accounting Controls are perceived by the companies that have undergone such a review. The Swedish Tax Authority has a very positive attitude towards them, but it is unclear what the companies' view of them is. It might also be of interest to compare the General Accounting Controls to the tax audits, from the companies' perspective. A study regarding the subsequent effects of the two different controls on the monitored companies and their performance could also be relevant. Further, we propose a study regarding the different monitoring functions' appropriateness for battling economic crime.

Our results indicate that there might be other functions than the actual audit of the annual statements that the companies value in the external auditor. It could be interesting to study whether the value of the external audit is perceived differently by small LLCs, compared to large ones. The results could indicate whether the external audit is most valuable to small or large companies. It is also possible to study the different parts of the external audit, namely the audit of the annual statements and the management audit, from the small LLCs perspective and to research which part they find the most valuable.

We have considered the possibility that small LLCs might lack the relevant accounting knowledge, and therefore a study of the accounting competence in small LLCs would be of interest. Possibly, a quantitative study with questionnaires could be suitable for this. Such a study could help in finding the most relevant monitoring function for a Swedish LLC.

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# Appendices

## Appendix A: Translations

English	Swedish
Articles of Association	Bolagsordning
Generally accepted accounting principles (GAAP)	God redovisningssed
Qualified audit report	Oren revisionsberättelse
Statutory audit	Revisionsplikt
The Association of Swedish Accounting Consultants	Sveriges Redovisningskonsulters Förbund
The Confederation of Swedish Enterprise	Svenskt Näringsliv
The professional institute for authorized public accountants, approved public accountants and other highly qualified professionals in the accountancy sector in Sweden	Branschorganisationen för revisorer och rådgivare, FAR
The Swedish Agency for Economic and Regional Growth	Tillväxtverket
The Supervisory Board of Public Accountants	Revisorsnämnden
The Swedish Bankers' Association	Svenska Bankföreningen
The Swedish Companies Registration Office	Bolagsverket
The Swedish Federation of Business Owners	Företagarna
The Swedish Tax Authority	Skatteverket

## **Appendix B: Interview Guide for the Swedish Tax Authority**

- How many years have you been working at the Swedish Tax Authority? What is your work title and what does this entail?
- In your experience, has your work assignments changed since the abrogation of the statutory audit for the small LLCs?
  - Has your workload changed?
- Do you experience that the legislative change is an issue that is discussed often at the Swedish Tax Authority?
- Which are the biggest changes in your work since the legislative change?
- Have you changed your sampling process since the legislative change?
- Which information do you consider relevant when deciding which companies to review further?
- Has the amount of tax audits been increased since the legislative change?
- What are your thoughts on the Swedish Tax Authority's increased possibility to review Swedish companies?
- Has there been a change in the way the Swedish Tax Authority communicates with the small companies?
- Are your reviews affected by whether a company has chosen to keep their external auditor or not?
- Do you consider the external audit to be a proof of quality?
  - In your experience, does the external audit contribute with information or does it rather act as an assurance?
  - Do you consider the external audit to be helpful for your work? If yes, how? If no, why not?
- Do you consider the need for an external auditor to differ between a small company and a large company, when it comes to fulfilling your specific needs?
- How does a qualified audit report affect your reviews?
- Do you experience an increase in errors in the information that the small companies report?
- Do you experience that small companies make mostly unintentional or intentional errors?
- Do you consider the risk for economic crimes to have changed?
- What kind of preventive work does the Swedish Tax Authority perform?
- How do you perceive the external auditor's obligation to give notice regarding suspected economic crime?
- Do you experience that there are some industries that are more often suspected to have engaged in irregularities or economic crime?
- Do you think that the statutory audit should be reintroduced for all companies or that the limit thresholds should be changed?
- Has the Swedish Tax Authority studied other countries - e.g. Denmark, Finland and England - and how their tax authorities have acted concerning the abrogation of the statutory audit?

## Appendix C: Interview Guide for the Swedish Companies Registration Office

- How many years have you been working at the Swedish Tax Authority? Which are your main duties as the Chief Legal Officer?
- Could you please recount for the development of the memorandum, SOU 2008:32?
- Do you experience that your work has changed since the abrogation of the statutory audit for the small companies?
  - Has your workload changed since the legislative change?
- How do you perceive hiring an accounting consult in comparison with establishing the accounting internally?
- Do you experience that the legislative change is an issue that is often being discussed at the Swedish Companies Registration Office?
- Which are the main changes in the Swedish Companies Registration Office's work since the legislative change?
  - Has the Swedish Companies Registration Office employed more people since the legislative change?
- Do you control whether a company, that has chosen to dismiss their external auditor, is obliged to have an external auditor or not?
- What information, from the companies, do you take part of?
- In a press release from 2012, the Swedish Companies Registration Office announced that the quality of the annual statements has changed, could you please recount for this?
- Do you experience the change in the quality to be disturbing for the Swedish Companies Registration Office's work?
- Has the Swedish Companies Registration Office's communication with the small companies changed since the legislative change?
- Do you consider the external audit to be a proof of quality?
  - Which part is most valuable for you - the reviewing role or the advisory and supportive role of the external auditor?
- Do you consider the need for an external audit to differ between a small and a large company?
- How, and when, do you take part of the audit report, as well as reminders from the external auditor?
- Of what use is the audit report to your work?
- Do you feel that your expectations, before the legislative change, have proved to be true?
- In your experience, do small companies make mostly unintentional or intentional errors?
- Do you think that the risk for economic crimes has changed since the abrogation?
- Do you think that the statutory audit should be reintroduced for all companies or that the threshold levels should be changed?
- Has the Swedish Companies Registration Office studied other countries - e.g. Denmark, Finland and England - and how their registration authorities have acted concerning the abrogation of the statutory audit?