

# English summary

## The auditors' obligation to report

In 1999, legislation was introduced requiring external auditors of Swedish joint-stock companies to report to the public prosecutor suspicions of economic offences committed by managing directors or company board members. This report examines both the auditors' attitudes towards this reporting requirement and its effects. The report is based in part on a secondary analysis of approximately thirty interview studies comprising a total of 160 interviews with auditors conducted during the period 1999 to 2003, and in part on a postal questionnaire survey sent to 1,350 auditors in 2003. Approximately 700 of these completed the questionnaire, with this sample being well-representative in relation to the variables gender, level of certification and organisational affiliation.

### The level of criticism expressed by the auditors has diminished

The respondents in the interview studies express criticism of the requirement to report. The nature of this criticism is similar to that expressed prior to the introduction of the legislation, and focuses on the fact that the legislation infringes upon their professional confidentiality and places the auditor in the role of a public authority. This involves a risk that the relationship with the client will deteriorate, together with the client's willingness to keep the auditor well-informed. In addition, the reporting requirement is described as lying outside of the auditor's traditional areas of competence and activity. The questionnaire survey shows that approximately half of the respondents (47 per cent) had a very negative attitude towards the reporting requirement at the time of its introduction in 1999. In 2003, one-third (34 per cent) remain very negative. Thus on the whole, the level of criticism has diminished somewhat.

The statistical analysis shows that, relatively speaking, one is most likely to find auditors with a negative attitude towards the reporting requirement among auditors from the older generation (those certified / approved prior to 1985), who work in the metropolitan areas of Sweden, and who have responsibility for a substantial number of clients (at least 50). Again in relative terms, one is least likely to find such auditors among those with the opposite characteristics: coming from a younger generation, working in non-metropolitan areas and with responsibility for fewer clients (at most 50). These differences are relative, however, and should not be overstated.

### The crime preventive effect is deemed to be small

The interviews show that some auditors regard the crime preventive effect of the reporting requirement to be small. This is partly because the clients' knowledge of the legislation is poor, and partly because these auditors themselves only have honest clients. Dishonest businessmen are regarded as finding ways of avoiding this control, or as choosing less honourable auditors and in so doing escaping the reach of the legislation. Some auditors do however regard the legislation as having a certain, albeit small, effect and in some cases it is in addition said to have provided the auditor with a good means of exerting pressure.

The questionnaire study indicates that the majority of auditors question the effectiveness of the legislation, but also that opinions are divided on this issue. Slightly less than 30 per cent of respondents agree that the reporting requirement constitutes an important constituent in anti-crime efforts, sixteen per cent regard it as having a good crime preventive effect, and 34 per cent regard it as being quite ineffective in practice. Only a minority (five per cent) believe that their clients generally have a good level of awareness of the auditor's obligation to report.

There is a tendency for those who believe that clients have a good level of awareness of the reporting requirement to regard the legislation as important to a greater extent and also to view it as having a good crime preventive effect. Auditors who regard the reporting requirement as an important constituent in anti-crime efforts are most likely to be found among approved auditors working in a firm other than the "Big-Four"<sup>1</sup>. Auditors who regard the reporting requirement as having a good crime preventive effect are most likely to be found among those working in "another firm" with medium-sized joint-stock

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<sup>1</sup> The "Big-Four" refers to firms of auditors within the companies: Deloitte & Touche, Ernst & Young, KPMG and Pricewaterhouse Coopers.

companies (50-100 employees) as their principal clients, and with a smaller number of clients (at most 50).

## The reporting requirement does not suit the role and competence of the auditor

Part of the criticism contained in the interviews relates to the way in which the reporting requirement is viewed as corresponding poorly with the role and competence of the auditor. This is confirmed in the questionnaire survey where only eleven per cent of respondents agree that the reporting requirement is well-suited to the work of the auditor. A similarly large proportion view the legislation as having strengthened the independence of the auditor and five per cent view it as having improved public and market confidence in auditors. Auditors who view the legislation as having improved their independence are, relatively speaking, more likely to be found among members of the Swedish Society of Registered Accountants (*Revisorssamfundet* – SRS) and among those with medium sized joint-stock companies as their principal clients, than among those affiliated to the Swedish Institute of Authorised Public Accountants (*Föreningen Auktoriserade Revisorer* – FAR) and those with smaller companies (with at most 50 employees) or large companies (over 200 employees) as their principal clients.

As regards having the penal-law related competence required to determine the offences covered by the reporting requirement – fraud, embezzlement and other breaches of trust, crimes against creditors, bribery, corruption and tax offences – approximately one-quarter (24 per cent) of respondents regard themselves as possessing such competence. Auditors who view themselves as possessing the necessary competence to determine that there is a suspicion of such an offence being committed are most likely to be found among the oldest generation of auditors. However, the interview study shows that a lack of relevant knowledge was only a minor problem since there is knowledge as to where this competence can be acquired, which was also confirmed in the questionnaire study.

## The relationship with clients has only rarely been affected

One reason underlying the reduction in the level of criticism is that the reporting requirement has had less of an effect than was originally feared on the relationship between auditors and their clients. The interview studies show that few of those interviewed had personal experience of a worsening of relations with their clients. This is confirmed by the questionnaire survey in that only five per cent of respondents felt that the amount of information provided by any of their clients had been reduced. Only two per cent also reported experiencing that a client had exhibited mistrust towards them as a result of their obligation to report suspected offences. In relative terms, auditors who have experienced a worsening in the information provided by a client are most likely to be found among those in metropolitan areas, with a large number of clients and with medium-sized joint-stock companies as their principal clients. Such auditors are least likely to be found among those located in other cities/areas, with few clients that are primarily comprised of small joint-stock companies.

In the interview studies, misgivings were expressed, not based on existing personal experience, that confidence might become damaged over time as awareness of the reporting requirement spreads. The questionnaire survey showed that approximately fifteen per cent of auditors believed that reporting a client might damage confidence among other clients of the same firm of auditors, and a similar proportion believed that doing so could damage an auditing firm's good name. In relative terms, auditors expressing this belief are most likely to be found among the oldest generation of auditors or among those with medium-sized joint-stock companies as their principal clients.

## Extensive additional training – minor changes to auditing practice

The interview study included descriptions of both a certain level of additional training and the perception that awareness of the reporting requirement remained relatively poor within the profession. The questionnaire survey shows however that fully 65 per cent of respondents have participated in additional training relating to the obligation to report suspected offences. The highest proportion was found among SRS-auditors, of whom almost three-quarters (72 per cent) have received additional training, primarily at the hands of the SRS/FAR/IREV. The proportion of auditors who have received internal training lies at the same level among SRS- and FAR-auditors (at approximately 47 per cent). Further, auditors at one of the Big-Four firms have received additional internal training to a greater

extent than at the others, and auditors with a large number of clients (at least 100) have received additional training to a greater extent than others.

The interview studies emphasised that auditing practice had remained unaffected, with the exception of something of a sharpening of the focus on those points affected by the reporting requirement. The questionnaire responses show however that almost half (44 per cent) have formulated routines for dealing with suspicions of the kind referred to in the legislation and that two-thirds (67 per cent) have clarified the nature of the available internal and external legal expertise that may be referred to if such suspicions were to arise. This was the case to a greater extent among the Big-Four auditing firms and among auditors with a large number of clients (at least 100) than among other firms of auditors and among auditors with fewer clients.

Twelve per cent of respondents further agreed that they have actually changed the planning and conduct of audits. Certified auditors agreed that this was the case to a greater extent than approved auditors, and auditors from among the older generation and those with a large number of clients agreed that this was the case more often than younger auditors and those with fewer clients. On the basis of 60 comments written in the context of an open ended follow up question, it can be seen that approximately one-third feel that the focus and level of attentiveness has altered somewhat. Approximately half state that they have furthermore introduced additional elements into their “checklists” or inspection programmes.

## The obligation to report suspected offences is being implemented with caution

In the interview studies, the fact that the crime preventive effect of the reporting requirement is regarded as being small is associated amongst other things with the fact that the requirement to report has not altered auditing practice and that the clients’ awareness of the requirement is low. The former point was confirmed to some extent in the questionnaire survey, as was the latter point, with only seven per cent of respondents reporting that they routinely inform their clients of this obligation whilst over 76 per cent inform their clients only when it becomes relevant to do so. Auditors at the Big-Four firms reported routinely informing their clients to a slightly lesser extent than others.

Otherwise, there is strong evidence that the reporting requirement is actually being implemented in practice, even if not in the first instance in the form of reports to the prosecutor. A number of the accountants included in the interview studies stated that they have become somewhat more cautious in their choice of clients. This was confirmed by one-third (36 per cent) of the respondents in the questionnaire survey. This tendency is somewhat stronger among auditors in metropolitan areas of Sweden than in other cities/areas. Almost half the respondents (47 per cent) have also pointed out their obligation to report suspected offences to a client in order to give added emphasis to something they have felt it necessary to remark upon. Of these, five per cent have done so on more than one occasion. In relative terms, this type of use of the reporting requirement is more common among SRS-auditors than it is among FAR-auditors. Slightly over 40 per cent of respondents have in addition conducted more detailed controls or conferred with a colleague or lawyer as a result of a suspicion having arisen. This is more commonly the case, relatively speaking, among auditors with a large number of clients.

Over six per cent of respondents, a total of 44 of 691 auditors, state that they have reported a suspected offence or offences to the prosecutor. Together these auditors have submitted a total of 57 reports. Here too the tendency is for auditors with a large number of clients to have taken this step to a greater extent than others. Further, auditors working in firms other than the Big-Four, or firms not affiliated with an international network, have reported suspected offences to the prosecutor to a somewhat greater extent than others.

Finally, the questionnaire study confirms one of the recurrent themes from the interview studies, namely one associated with the concept “may be suspected”, which prescribes the submission of a report where the level of suspicion involved is relatively low. There is some degree of caution among auditors in their application of the legislation. In general, the respondents report wanting to be very sure of a matter before submitting a report. Four of five respondents want to be at least 75 per cent certain that an offence has been committed before being willing to report their suspicions. As many as one third of respondents want to be 95 or more per cent sure before considering the submission of such a report.