# TO AUDIT OR NOT TO AUDIT: DEBUNKING THE MYTHS ABOUT AUDIT FOR SMEs

**The European Federation of Accountants and Auditors for small and medium-sized enterprises (EFAA) president Bodo Richardt, and director Paul Thompson share their views on a recent report by the Swedish National Audit Office on the supposed benefits of dropping audit requirements for SMEs. Interview by *Vincent Huck***

**The Swedish National Audit Office (NAO), an independent body of the Swedish Parliament, published a report in December questioning Sweden's 2010 decision to abolish audit requirements for small limited liability companies.** When audit thresholds are raised, politicians often argue that such measures reduce costs and administrative burdens for small businesses. However, the Swedish NAO report found that these benefits hardly ever transpired. More importantly SMEs not undergoing an audit tend to perform less well.

**The Accountant: I'm sure you've seen the report from Sweden. What did you make of the document and its findings?**

**Bodo Richardt:** We believe it's a very, very important piece of evidence. There have been a couple of reports talking about the consequences of raising the thresholds in accordance with the EU directives. But the downside was that these reports contained very little evidence. There have been publications in Germany and the UK, including academic research, saying that raising the thresholds and therefore leaving a rather large group of smaller companies unaudited resulted in a loss of quality without any reasonable gain. But the evidence was very limited.

When we talked, frequently, to policymakers, such as those in the European Commission or regulators, the common and constant comment always was: "It's the relief from unjustified burdens rather than anything else."

Now, to have an evidenced-base discussion, [this report] is very important. Because very often it's only political arguments and there is not enough evidence-based argumentation. In this respect, this report from the National Audit Office of Sweden – which is, so to speak, the auditor general of Sweden – is a very important paper showing the evidence.

Very often, things like this happen at historic moments when either a threshold is moved – normally raised – or, for example, there has been a situation like in Great Britain when the audit obligation of smaller companies has been abolished totally. There are historic moments then research has come in and tried to look at the effects. Here, actually, it has been a history of discussing the benefits and the disadvantages in Sweden over a rather long period from 2006 to 2010.

In the end, the decision was taken to abolish the audit obligation for smaller companies. The effect is stunning because we're talking about hard facts here. In principle, what came out of the report was that the promised benefits didn't materialise. There was no higher growth, so being relieved of this administration burden didn't lead to higher growth. The cost savings, in effect, were minimal. On the other side, the downside, the disadvantages were very clear – a lack of transparency and a lack of control that wasn't followed up.

This was a severe criticism by the National Audit Office. We found this very interesting because that is a constant reminder we do in our response to public consultations: "Please do post-implementation reviews. Look at the effects of what you've done. It doesn't matter whether it's positive or negative, but look at the effects." It's extremely important and very interesting to look at this evidence and the effects; it mirrors exactly the literature that claims that the abolition of audits for smaller companies doesn't give the promised advantages, but invites a lot of disadvantages.

I've just mentioned transparency and control. I would almost put that into reverse order because control, by and of the company, is by the management. If you don't have hard audits on the facts, on the figures, on the numbers, it's probable that the chance that you have a tight control of your business and know exactly where it's heading is reduced. Also, transparency is not only a question of the general stakeholder discussion but also concerns the increasingly important questions of avoiding tax evasion, as well as, fighting economic crime and fraud. This is why it's an extremely interesting and very valuable piece of documentation.

**Paul Thompson:** Bodo has very expertly summed up our views on this. In terms of evidence and the effect of not having an audit, some years ago in the UK –- it is a dated piece of work now – somebody took a look at the findings made at Companies House. They found that small company unaudited accounts had errors like balance sheets that didn't balance. It's enough to make your hair stand on end, the thought that you could file accounts that actually were not numerically correct in the simplest of things, that the balance sheets balanced. They weren't balancing because obviously there had been no third party check.

The other thing is, obviously, there are a lot of people who have a view that: "Ah, you should operate free and liberal markets and that companies should be free to choose for themselves in the good old American way, unregulated. They make the choices."

I think there's a very strong public interest aspect here. That is that is incumbent on the Commission and the people who are charged with looking after the public interest that they very thoroughly research the potential impact and then do the post-implementation review of that impact to look at the wider business and societal impacts.

Clearly, here, the evidence that was done in the case of Sweden was quite persuasive to suggest: "Do you know what? It seems it was the wrong decision to exclude SMEs from audit."

**Richardt:** To add to this, look at the source of this report – the National Audit Office, so to speak, the auditor general. It can't get any more authoritative than that. It's not academic. It's not a very able organisation like ours that's drawing on many resources from our members, but it's the National Audit Office of Sweden. There's no interest to be biased about this, so I think it's very authoritative.

**The Accountant: You picked up on the findings of the research but the summary didn't really explain the reason why the supposed benefits of getting rid of audit were not met (the full report being in Swedish). Did you look further into it as to why it doesn't provide the expected benefits in terms of cost and in terms of being less burdensome?**

**Richardt:** It's partially explained in the paper and it mirrors something that is part of a bigger picture: normally, a third party, an objective control in the form of an audit, exerts a certain pressure to perform. That applies to both control and transparency.


Bodo Richardt

This obligation, if it's a statutory audit, may be imposed by the government or the laws. It may be self-imposed in the case of a voluntary audit.

There have been papers, not many but some, indicating that performance was better if this control worked, even if it is self-imposed. The British study by Jarvis and Collis, for example, showed there was evidence that if you undergo a certain rigorous control, then you perform better.

There are similar studies for smaller listed companies, that show when there is pressure from the outside to be well controlled and have a greater transparency, they, as a general rule, perform better.

**Thompson:** This is actually very intangible, unfortunately, but I do see how having this external impetus imposes or encourages a degree of financial discipline by the entity and its stewards. That is what audit does.

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**Richardt:** That is what we always believed: getting rid of rules and regulation is not, in itself, positive. You have to look at the rules and the regulation. We always call for what is "good accounting". We call for better regulation. Then performance tends to be better. Of course, if there is unjustified and overburdening administration effort, then it's negative – there is no doubt about it.

Far too often in the political discussion it has been a very popular argument by politicians to simply say: "Relief of burden means doing less for everybody." This is saying it very directly. That is wrong. It's such a general statement."

*Read the full interview at www.theaccountant-online.com*