Determinants of Voluntary Audit in Micro-Entities

A qualitative study of micro-entities in Skellefteå

Authors: Elin Persson
Franziska Schöps

Supervisor: Kim Ittonen

Student
Umeå School of Business and Economics
Spring semester 2012
Master thesis, one-year, 15 hp
Thesis information

Academic Institution: Umeå School of Business and Economics, Umeå University

Program: Master in Accounting

Supervisor: Kim Ittonen

Authors: Elin Persson and Franziska Schöps

Thesis Topic: Determinants of Voluntary Audit in Micro Entities – A qualitative study of micro-entities in Skellefteå

Thesis Defense Date: 30th May 2012

Thesis submitted in partial fulfillment of the requirement for the Master Degree in Accounting (one-year) from the Umeå School of Business and Economics at Umeå University.
Abstract

Smaller companies have less manpower than larger companies to manage administrative tasks. EU has made it possible for member states to reduce the accounting and audit requirements for small companies and Sweden introduced the option of voluntary audit from the fiscal year of 2011 for micro-entities that do not exceed the threshold values of 3 employees, 3 MSEK turnover and 1.5 MSEK balance sheet total. The values are lower than in other countries with voluntary audit. Due to this, previous research on voluntary audit was conducted on larger companies than Swedish micro-entities. The determinant factors for voluntary audit are therefore different in these micro-entities than in SMEs. The purpose of our study is to find what the decision-makers in micro-entities perceive as their reason to retain or dismiss their auditor as it became voluntary.

As a starting point, we theorize that some of the relevant factors in previous studies on voluntary audit in SMEs can also have significance for micro-entities. Furthermore, that the relationships between the auditor and client can affect the decision whether to keep the auditor or not, especially as the companies are small enough for the decision-maker to have regular contact with the auditor and the small size of Skellefteå where we conduct the interview study. Our sample is eleven micro-entities in Skellefteå, out of which three have retained their auditor and intend to keep them in the company, four who are registered with an auditor but will not have an auditor next year, three who dismissed their auditor as soon as possible and one who was started after the law came into action and had never had auditor nor accountant. The determining factor for voluntary audit is in all but one case the advice of the auditor or accountant. No other factor was found to have any effect of magnitude.

Previous research in the area have found connections between factors such as debt level, firm size, separation of ownership and management, non-audit services, external demand for audited financial statements and net benefits of audit. As the micro-entities in our sample have little or no debt and no separation of ownership and management we found that these factors are irrelevant to the choice of voluntary audit in our sample. Most of the companies perceive these as factors that would be relevant in a larger company, however. It is the largest firms (by turnover) that have kept their auditor, but do not mention this as a determining factor. Almost all companies have non-audit services from the audit firm, which do not seem to affect the voluntary audit decision. Those who had or will dismiss their auditor see no additional benefits by having an auditor than by having an accountant, which is also supported by the fact that only two companies could mention any benefit with audit aside from external demands from the government or tax authority. All companies believe that there are external demands for audited financial statements, but this was not found to be a determining factor.

Relationship factors such as trust, interdependence and service quality do not determine the choice for voluntary audit, but do determine if the companies asked the auditor or accountant for advice on retaining or dismissing their auditor. We found that the decision-makers in the micro-entities all asked the professional they have the best and closest relationship with if they should have voluntary audits, and as all auditors replied to continue with the audit whereas all accountants did not consider it as necessary, relationships can definitely be seen as a contributing, but not determining, factor for voluntary audit.
Table of Contents

Abstract................................................................................................................................. iii
List of Tables and Figures ........................................................................................................ viii

Chapter 1: Introduction ........................................................................................................ 1
  1.1 Introduction to SMEs and Micro-Entities ................................................................. 1
  1.2 Problem Background ............................................................................................... 1
  1.3 Research Question .................................................................................................... 2
  1.4 Purpose of the Study ............................................................................................... 3
  1.5 Limitations of the Study .......................................................................................... 3
  1.6 Definition of Key Terms .......................................................................................... 3
  1.7 Disposition ............................................................................................................... 5

Chapter 2: Methodology ....................................................................................................... 6
  2.1 Choice of Subject ...................................................................................................... 6
  2.2 Preconceptions ......................................................................................................... 6
  2.3 Perspective ................................................................................................................. 7
  2.4 Research Philosophy ............................................................................................... 7
  2.5 Research Approach .................................................................................................. 8
  2.6 Research Design ....................................................................................................... 9
  2.7 Research Strategy ..................................................................................................... 10
  2.8 Sample Selection ..................................................................................................... 10
  2.9 Data Collection ........................................................................................................ 12
  2.10 Data Analysis ......................................................................................................... 13
  2.11 Quality Criteria ..................................................................................................... 14
  2.12 Ethical Considerations .......................................................................................... 15

Chapter 3: Literature Review .............................................................................................. 16
  3.1 Demand for Audit ..................................................................................................... 16
    3.1.1 Purpose of Audit ............................................................................................... 16
    3.1.2 Agency Perspective ......................................................................................... 16
  3.2 Audit Regulation ...................................................................................................... 17
4.4.2 Benefits ................................................................................................................. 38

4.4 Education Level ....................................................................................................... 40

4.5 Non-Audit Services ................................................................................................. 41

Relationship Factors .................................................................................................... 41

4.6 Client Acquisition and Retention ........................................................................... 41

4.7 Personal and Private Connections ......................................................................... 42

4.8 Affective Commitment ............................................................................................. 43

  4.8.1 Service quality and Satisfaction ........................................................................ 43

  4.8.2 Trust ..................................................................................................................... 43

  4.8.3 Interdependence .................................................................................................. 44

4.9 Calculative Commitment ......................................................................................... 44

Further Relevant Findings ............................................................................................. 45

4.10 Other Determinants of Voluntary Audit ............................................................... 45

4.11 Perception of the Function of Audit ....................................................................... 46

Chapter 5: Analysis of Empirical Findings ................................................................. 47

Business Factors ............................................................................................................. 47

5.1 Firm Size and Agency Factors ................................................................................ 47

5.2 Amount of Debt, Credibility and Insurance Effects to Banks ............................... 48

5.3 Credibility with Business Partners ......................................................................... 48

5.4 Cost-Benefit Considerations ................................................................................... 49

  5.4.1 Costs .................................................................................................................... 49

  5.4.2 Benefits ............................................................................................................... 49

5.5 Education Level ....................................................................................................... 50

5.6 Non-Audit Services ................................................................................................. 51

Relationship Factors .................................................................................................... 51

5.7 Client Acquisition and Retention ........................................................................... 51

5.8 Personal Connection ............................................................................................... 52

5.9 Affective Commitment ............................................................................................. 53

  5.9.1 Service Quality and Satisfaction ........................................................................ 53
5.9.2 Trust ........................................................................................................ 54
5.9.3 Interdependence ..................................................................................... 55
5.10 Calculative Commitment ......................................................................... 55
5.11 Further Relevant Findings ........................................................................ 56
  5.11.1 Other Determinants of Voluntary Audit ............................................. 56
  5.11.2 The Perception of the Functions of Audit .......................................... 56

Chapter 6: Conclusions, Limitations and Recommendations .................... 57
  6.1 Conclusions .............................................................................................. 57
  6.2 Limitations and Recommendations ....................................................... 58

References ......................................................................................................... 59

Appendix ........................................................................................................... 65
List of Tables and Figures

List of Tables:
Table 1: Fundamental differences between quantitative and qualitative research strategy……………………………………………………………………………10
Table 2: Definition of SMEs………………………………………………………………………………21
Table 3: Number of Swedish companies divided by size………………………………………21
Table 4: Overview of micro-entities included in our sample……………………………..35

List of Figures:
Figure 1: Demand for auditing from an agency perspective……………………………17
Figure 2: Relationship benefits……………………………………………………………………..28
Figure 3: Affective and calculative commitment……………………………………….29
Chapter 1: Introduction

This chapter provides an introduction of the research area and the problem background including the research question and the purpose of the study. We present the limitations of the study, definition of key terms and conclude with the disposition of the thesis.

1.1 Introduction to SMEs and Micro-Entities

Small and medium-sized enterprises (SMEs) play a major role in the global economy as they account for 99 per cent of all companies worldwide. In the European Union (EU) there are 20.9 million SMEs which equal a percentage of 99.8 of total companies (Eurostat, 2011, p.11; Vasek, 2011, p.115). As SMEs can be divided into medium-sized, small and micro companies, we find that micro-entities are highly relevant in the economy as they make up 92 per cent of the companies in EU. Sweden has an above average representation of micro-entities compared with the other countries in the EU (Eurostat, 2011, p.12).

SMEs differ from larger companies in their requirements, inter alia regarding their financial reporting, and therefore make it necessary for the authorities to respond to their need to simplify financial reporting by implementing efficient measures and programs specialized for SMEs (European Commission, 2005b, p.26). Attempts to decrease the administrative burden and costs on financial reporting requirements have taken place in the previous years to strengthen the competitiveness of SMEs and support their businesses (IASB, 2010, p.2). Sweden reacted to the needs of SMEs by introducing a change in Annual Account Act (Årsredovisningslagen, ÅRL, SFS 1995:1554) in 2010 (SFS 2010:834). Since 1980 all Swedish limited companies (aktiebolag) had to conduct an audit on their financial statements, but the new legislation allows companies that do not exceed certain criterias to be exempted from the statutory audit. Private limited companies which exceed two of the following criteria: more than 3 employees, more than 1.5 MSEK on balance sheet total or more than 3 MSEK in turnover, still have to carry out an audit. From November 1st 2010, all other private limited companies, around 250 000 in 2010, can apply for audit exemption for the next financial year (Regeringskansliet, 2010). These thresholds mean that only micro-entities are exempt from audit in Sweden.

1.2 Problem Background

The EU Fourth Company Law Directive (78/660/EEC) provides member states with the option to introduce exemption of statutory audit for qualifying medium-sized, small or micro entities (European Economic Community, 1978). Sweden is as of 2010 one of the countries that have made use of this opportunity, but with much lower thresholds regarding the qualification criteria turnover, balance sheet total and number of employees for exemption (Regeringskansliet, 2010). Prior studies on voluntary audit have rarely focused on SMEs in Sweden, which indicates a need for research in this area as large and small firms differ immensely in their business strategy, organization structure and specific financial reporting needs. According to the only current available study about SMEs in Sweden, the authors found that 73 per cent of the SMEs in Northern Sweden would continue having their accounts audited even though they are exempted from the statutory audit by law (Svanström & Boter, 2012, p.17). Other studies conducted in different countries can confirm that there are various determinants for choosing a voluntary audit (Allee & Yohn, 2009; Carey et al. 2000; Collis et al.
2004; Collis 2010; In-Mu et al. 2008; Kim et al., 2011; Lennox & Pittman, 2011; Marriot et al., 2006; Niemi et al. 2012; Seow, 2001). These findings indicate that the audit has a certain value for companies which offset the costs of engaging an external auditor. The studies were however conducted on companies that were larger than the Swedish micro-entities exempted from mandatory audit, which means that the results might not be applicable to companies the of Swedish micro-entities exempted from audit.

One of the most common drivers for voluntary audit are firm size, debt and ownership structure which is accompanied by agency conflicts and control demands due to a separation of ownership and delegation of tasks (Carey et al., 2000, p.39; Fama & Jensen, 1983, p.304; Hay & Davis, 2004, p.40). Hence, the choices of micro-entities for conducting a voluntary audit might differ from larger firms as micro entities are small when measured by organizational complexity, debt structure or the degree of dispersed ownership. Furthermore, the perception of possible benefits of an audit can vary between companies of different sizes (Collis et al., 2004, p.97). According to Svanström and Boter (2012) are not only business factors the underlying reasons for conducting an audit in Swedish SMEs but also relationship factors such as trust and commitment can have significant influence on the decision. Moreover, in smaller cities the auditor acts like a close partner, professional expert and sounding board (Svanström & Boter, 2012, p.19) rather than just an external control agent. These factors could also prove to be determining reasons for micro-entities to have an audit. Collis (2012) provides the only study which is available about micro-entities and their determinants for voluntary audit. She found evidence from the UK that the order of drivers for voluntary audit in respect to their importance is different in micro-entities than in larger companies, which again suggests that micro-entities diverge from SMEs.

In 2011, which was the first year after the new legislation, 34 000 of possible 250 000 Swedish companies had decided to make use of their exemption, half of which were companies founded after November 1st 2010 (Rapport från Företagarna, 2011, p.3). Companies founded after November 1st 2010 where able to directly choose to be without an auditor, whereas existing firms have to apply to have the auditor dismissed (Rapport från Företagarna, 2011, p.6). As the exemption legislation is quite new, there is little research on how micro-entities do without audit, why they choose to retain or dismiss their auditor and other related topics specifically in Sweden. As the thresholds for statutory audit is much lower in Sweden than in most other countries, there is a definite research gap to be filled.

1.3 Research Question
Our research questions are based on previous literature gaps and the implementation of the new legislation regarding audit exemption for SMEs in Sweden:

1. How does the business owner think that the external demands for audited financial statements affected their decision to retain the auditor after it became voluntary?
2. Has the business owner who has one or more of the factors listed below kept their auditor in a higher degree than ones who do not? If so, why?
   a. high separation between ownership and management in the company
   b. believe there are benefits of auditing other than external or legislative demands
3. How does the business owner think that the relationship between them and the auditor affected their decision to retain the auditor after it became voluntary?

1.4 Purpose of the Study

Micro-entities account for nearly 97 per cent of all companies in Sweden and therefore have a significant role in the Swedish economy. As we found only one peer-reviewed study about the determinants of voluntary audit in micro-entities, which focused on the UK, our aim is to contribute to the unexplored area of research on micro-entities and their choice on voluntary audit.

In regard to the Swedish law change for private limited companies from November 1st 2010, that provide micro-entities the option of voluntary audit, our research purpose is to investigate the determinants for remaining or dismissing the auditor in Swedish micro-entities by considering both business-related and relationship-related drivers. The majority of previous studies about voluntary audit in SMEs are quantitative studies whereas we are concerned with the personal perception of the owners of the micro-entities about voluntary audit and want to explore the reasons behind their choice with our qualitative approach.

Therefore, the focus of the study will be the individual business managers/owners perception of their reasons for choosing to retain or dismiss the auditor in their company. By conducting an interview study, we aim to find the determinant factors of voluntary audit in micro-entities in Skellefteå.

1.5 Limitations of the Study

- This study will only focus on micro-entities in Skellefteå.
- The sample size is limited.
- The sample is a heterogeneous sample as the respondents are not active in the same business area.
- The interview questions are based on previous literature about SMEs as there were no studies about micro-entities available in regard to the research purpose when we prepared the interview question.
- This thesis is written in English whereas most of the interviews (nine out of eleven) were conducted in Swedish which makes it possible that quotes and meanings might differ slightly as exact translations are sometimes not reliable due to different choice of words in the two languages.

1.6 Definition of Key Terms

Accountant: A white-collar worker who processes financial information. In this thesis, we have not differentiated between “bookkeeper”, “accountant”, “accounting assistant” and other comparable terms used by our respondents. In all those occasions, we have translated the words into “accountant”.

Affective Commitment: An emotional attachment between people that creates a loyalty in business relationships. The commonly cited building blocks of affective commitment are: (satisfaction with) service quality, trust and interdependence. Affective commitment focuses on the positive reasons to stay, as oppose to calculative commitment.
Audit: The control of the accuracy regarding accounting and reporting legislations of the yearly financial statements produced by the micro-entity.

Auditor: An auditor is an authorized white-collar worker that has the required competence in regard of education and experience to audit of a financial statement.

Audit firm: Professional firm that provides audit and accounting services. We use the term for all firms employed by our respondents for audit and accounting.

Audit Regulation and Standards: Ensure that the auditor follows certain criteria and guidelines when conducting an audit to increase quality and comparability as well as credibility and reliability of the presented financial information. A Swedish audit should ensure that the financial statements are done in accordance with generally accepted accounting principles (god bokföringssed).

Calculative Commitment: In some ways the opposite of affective commitment, based on the negative or costly consequences of ending the relationship.

Control Risk: Occurrence of material misstatement and its risk to not be prevented, detected or corrected by internal control.

External Control Function: Referring to the external control mechanism of an audit that can act as an assurance to third parties (e.g. the state) that the financial statements are prepared according to certain standards and provide credible and reliable financial information.

External Demand: Demand from external sources such as banks and other creditors, customers, tax office, government and other stakeholders.

Inherent Risk: The likelihood of a claim to material misstatement while having no related controls.

Interdependence: Combines the terms co-operation, adaptation and knowledge transfers. Interdependence results from repeated interaction where both parties are willing to learn and change to better suit the other party.

Internal Control Function: In the agency theory, internal control means that the audit can act as a control mechanism within the firm to assure the goals of owners and management respective employees are aligned. This is important as information asymmetry and conflict of interest can exist between these different parties.

Loyalty: Can be divided into two parts; behavioral loyalty is the intention to stay in the relationship and attitudinal loyalty is speaking positively about the other party.

Micro-Entities: The definition of micro-entities in this study refers to the definition by the European Commission which defines micro-entities as companies that do not exceed the following numbers: 10 employees, turnover 2 MEUR and balance sheet total 2 MEUR. Due to the low thresholds in the Swedish audit exemption, the micro-entities in our sample are much smaller than this. There does not exists a generally accepted term for them which is why we use micro-entities throughout the thesis, and the analysis and conclusion should be read with the Swedish thresholds in mind.

Net Benefits: Monetary and non-monetary benefits that outweigh the costs of audit.
Non-Audit Services: Non-audit services are all services provided by the audit firm that are not related to the actual audit, for example bookkeeping, tax- or consulting services.

Relationship: We use three kinds of relationships in the thesis; business relationship (no emotional attachment), personal connection (based on an emotional, but not deep/close, attachment or feelings of someone close (i.e. friend of my friend)) and private relationship (friendship, romance and other closer relations).

Small and Medium- Sized Entities (SMEs): In this thesis we use the European Commission’s definition, based on number of employees (less than 250), turnover (250 MSEUR) and balance sheet total (43 MEUR) and which distinguishes further between medium-sized, small and micro entities.

Statutory Audit: Requirements by law for companies that obliged them to conduct an audit regardless of their choice.

Voluntary Audit: Companies that fulfill certain criteria regarding number of employees, turnover and balance sheet total can voluntarily choose if they want to conduct an audit as they are exempt of the statutory audit.

Voluntary Audit in Sweden: Companies that do not exceed more than one of the following criteria according to ÅRL chapter 9:1 (SFS 1995:1554): 3 employees, 1.5 MSEK balance sheet total and 3 MSEK turnover can choose to have an audit.

1.7 Disposition

Chapter 2 (Methodology): Introduces the choice of method for our study, and provides an overview of choice of subject, preconceptions, perspectives, research approach and design, data collection methods and analysis, relevant quality criteria and ethical considerations.

Chapter 3 (Literature Review): A summary of previous literature on auditing in SMEs and relationship marketing relevant to our research purpose. It represents the basis for our interview design and the following analysis of the empirical data.

Chapter 4 (Empirical Findings): The empirical findings of the collected interview data from our sample companies.

Chapter 5 (Analysis of Empirical Findings): Analysis of the empirical outcome of our research study by referring back to previous literature, presented in chapter 3, and discuss further relevant findings.

Chapter 6 (Conclusions, Limitations and Recommendations): This chapter presents the conclusions of our research study thereby addressing the research questions. Furthermore, limitations will be discussed and impetus for further research will be given.

References: The complete reference list of literature used in this study is included in this section.

Appendix: The interview questions for our sample companies are disclosed in this section.
Chapter 2: Methodology

This chapter will give an overview of the research methods chosen for our study and explain the reasons behind the choices. We will review the choice of subject, our preconceptions, perspective, research approach, research methods, research design, data collection methods, data analysis, quality criteria and ethical considerations.

2.1 Choice of Subject

Our choice of subject builds on our specialization in audit and accounting and our interest in the subject was founded in knowledge obtained in previous courses, especially Advanced Auditing. As we discussed the purpose and possible advantages respective disadvantages of auditing, we decided to study the reasons behind the choice of having a voluntary audit. As Swedish public limited companies as well as Swedish private limited companies exceeding certain criteria are required by law to have an auditor, we could limit our research to micro-entities that are exempted from a mandatory audit in Sweden by the new legislations on voluntary audit provision from 1st November, 2010. The choice of voluntary audit is quite new and untried in Sweden and as previous studies about voluntary audit have been predominantly focused on Anglo-Saxon countries and larger companies than exempt in Sweden, we considered it an interesting and unexplored area to examine the detailed reasons of micro-entities for retaining or dismissing the auditor.

Since our purpose is to understand the perception of the companies on the value of an auditor, we are focusing on possible external demands as well as on internal drivers for the choice of voluntary audit. The determinants we focus on are the relationship between business actors, in particular the relationship between the micro-entity’s decision maker (owner or manager) and their auditor. A general assumption is that relationship factors are more important in smaller cities, therefore we conducted our study in Skellefteå, which is a town of about 35 000 people in the North of Sweden. We believe that our study can contribute to a deeper understanding about the perception of audit and role of the auditor in micro-entities in similar communities.

2.2 Preconceptions

It is important to state the background of those who have conducted the research in order to reveal preconceptions. Both authors are students at the Master’s Program in Accounting at the Umeå School of Business, where we obtained advanced and adequate knowledge to conduct a study in this topic. Through our education we have gained insights in the purpose and value of audit as well as its theoretical backgrounds. We must consider that there might be preconceptions generated from our educational background, as the education is directed towards understanding the principles of auditing in larger companies and not the actuality of auditing in small companies, which might have directed us in the design of the study. It is also important to note that one author is from Skellefteå and might have preconceptions about the people in the town and how they think, which might affect the analysis of the interviews. Weber (1949) states that the researchers’ influence of their values needs to be reduced to an acceptable level. We have tried to conduct the study with a high degree of objectivity to ensure its validity.


2.3 Perspective
According to Eriksson and Wiedersheim-Paul (2006), perspective can be described as the chosen point of view from which one looks at a problem. Individuals differ in the way they perceive and experience reality, and the judgment and discipline of the individual influences their perspective. Thus, it is necessary that the choice of perspective is reliable to allow a high-quality study accompanied by a clear understanding of the subject matter (Eriksson & Wiedersheim-Paul, 2006, p.39).

The objective of our study is to find the reasons behind the choice of voluntary auditing financial statements in micro-entities in Skellefteå. To fulfill this objective we will investigate the perspectives of a sample of micro-entities on retaining the auditor when not required to do so by law while at the same time considering previous research related to voluntary audit. Moreover, we are interested in the influence of relationships between the auditors and their micro-entity clients, this line of study will be based on relevant studies on relationships and relationship marketing. The outcome of our study will aim to explain internal and external incentives for audit in exempted micro-entities in Skellefteå and contribute to the growing field of research in voluntary audit.

2.4 Research Philosophy
Research philosophy answers how one generates and accepts knowledge, as the view and attitude to it can differ between researchers (Saunders et al. 2009, p.107). In general, business research methods comprise two main philosophies, epistemological and ontological philosophies (Bryman & Bell, 2011, p.4).

Epistemology considers what we can accept as knowledge in particular area and asks if a researcher can apply the same principles, procedures and ethos used in natural science for social science. Epistemology consists of two different viewpoints: Positivism is the perception that there is no difference between objects studied in natural science and people of social science. Hence, the social world can be studied in the same way as the natural science. In contrast, interpretivism views social science as different from natural science and respects the unique features of people and their institutions. Thus, social research must be carried out with a different logic to include the characteristics of humans. The aim of the social scientist is “to grasp the subjective meaning of social action” (Bryman & Bell, 2011, p.17). Furthermore, interpretivism allows for surprising findings, implying that the researcher is more likely to change the direction of the study (Bryman & Bell, 2011, pp.15-19).

Ontological research philosophy is concerned with the nature of social entities by referring to ontological considerations. Ontology decides if one is an objectivist by viewing a social entity as something that exists external and separate from social actors, or a constructionist by viewing the entity as constructed by social interactionism of the people living in them (Bryman & Bell, 2011, pp.20;23). Objectivists assume that the social world can be divided into facts, things or objects. Organizations and cultures thereby exist in a reality that is independent of the social actors in it. It can be seen as a social order stipulating certain behaviour and rules for the individuals. In contrast, the constructionist regards the social world as something accomplished by the individuals living in it. Relationships and actions are the determining factors (David & Sutton, 2011, pp.85-86). This means that social phenomena and their categories change
continuously because they are created in everyday life. Consequently, the social entity does not exist outside the social actors (Bryman & Bell, 2011, p.21).

Epistemologically, we follow the interpretivism approach in our study and take the view of a constructionist when considering ontological assumptions. As our purpose is to understand the micro-entities perception of the value of audit and their reasons behind the choice of voluntary audit, we try to view the choice from the micro-entities points of view. We aim to gain an insight in the contextual understanding of their specific reasons. We are interested in the respondents’ subjective thoughts and opinions. We therefore believe that the social actors influence their environment and that their actions are meaningful. Moreover, we respect that people are different from the objects of natural science and that we need to interpret how they construct their actions. Hence, we can reject the positions of positivism and objectivism for our study and therefore conduct our research in line with interpretivism and constructionism.

2.5 Research Approach

A well conducted study must achieve a connection between research and theory. However, this is not always straightforward and easy. Research approach is therefore concerned with the way data is collected (Bryman and Bell, 2011, p.7). The most common division between different research approaches is made by distinguishing between deductive and inductive approaches, but there is also a frequently used middle ground called abductive.

In a deductive study the researcher constructs a hypothesis based on previous knowledge (Bryman & Bell, 2011, p.11) and seeks to test the hypothesis (David & Sutton, 2011, p.83). With a deductive approach, the theory guides the research process including the data sampling process (Royse, 2011, p.24). In particular, it is interested in examining the relationship between two variables so that the researcher can either confirm or reject the hypothesis. This usually includes variation measurement and one can say that deductive research demands a greater and more structured data collection process (David & Sutton, 2011, p.84).

Inductive research is conducted to build theory based on data collection. It is also called exploratory, as it often looks for new phenomena where the correct measure is not obvious (Royse, 2011, p.25). The findings or observations are then implemented in a theory, which is the outcome of inductive research and means that the outcome should be somehow generalizable (Bryman & Bell, 2011, p.13).

The research approach in our study is the mix between deductive and inductive approach also called abductive. We seek to understand the perception of micro-entities concerning the choice of voluntary audit. This means we are conducting an exploratory study where we aim to find detailed and rich answers, which we reflect upon in light of the previous research gathered. This is consistent with an inductive approach. Furthermore, we base our research questions on relevant studies regarding characteristics of SMEs\(^1\) (Small and Medium Enterprises), internal and external audit demand in SMEs as well as important legislation for SMEs and micro-entities. We are

---

\(^1\) The literature review is based on research on SME’s as there was no literature available on voluntary audit in micro-entities.
however open for new directions and issues, which means that we do not test a hypothesis but still base our research on a framework of previous studies from which we develop research questions. This is consistent with the deductive approach. Nevertheless, we do not follow a clear and linear process when conducting the interviews. Our motives are to allow for unexpected answers as we are going to ask open questions, from which we might be able to extend or revise our study. A strict deductive research would limit our research to only collecting numbers without considering the motives behind the choices, including possible relationship influences. Thus, we have decided to follow an abductive approach as it will provide the best answers for our research question.

2.6 Research Design

According to Royse (2011) the research design is the framework guiding the collection and analysis of data. When deciding on a research design, one should keep in mind the following factors as they highly influence the choice of the appropriate research design:

- Expressing causal connections between variables
- Generalizing to larger groups of individuals than those actually forming part of the investigation
- Understanding behavior and the meaning of that behavior in its specific social context
- Having a temporal (over time) appreciation of social phenomena and their interconnections (Bryman & Bell, 2011, p.40).

Bryman and Bell (2011) further distinguish between five different research designs, namely experimental design, cross-sectional design, longitudinal design, case study design and comparative design. Experimental design is hardly used in business research as it manipulates an independent variable to examine the influence on the dependent variable. Obviously, many variables in business research, for instance gender, cannot be manipulated. A cross-sectional design is used to collect different kinds of data for a variety of cases while investigating at least two variables and their relationship. The observations are made in a single phase. A longitudinal design can be seen as an extended social survey that looks at a sample and repeats the sample at another time. This type of study is conducted to investigate evolutions in a specific topic. A case study design refers to the detailed study of a single case with the intention to explain special characteristic of the case in a specific environment. A comparative design investigates contrasting cases by using comparable methods. This research method is used when the intention is to give a deeper understanding of social phenomena (Bryman & Bell, 2011, pp.45-63).

In our study we use a cross-sectional design due to the fact that we collect data from a number of micro-entities and seek to investigate a variety of cases by having face-to-face interviews, this design is the most appropriate. In our study, cases are the different micro-entities that we are going to interview about their perceptions. This allows for and supports our research by identifying variations in the answers of the various micro-entities. Furthermore, we collect the data in one phase, a period of two weeks, so we can achieve a greater comparability and reflect the different views accurately. We are interested in the relationship between the choice of voluntary audit and the motives behind that choice. Therefore, we have several variables to consider in our interviews,
based on findings in previous studies. This is particularly true when looking at our research purpose; we aim to find the determining factors in the choice of non-mandatory audit. The cross-sectional design aids us in examining fine variations in the variables included in our research. Hence, we think that a cross-sectional design is the most appropriate one for our research.

2.7 Research Strategy

Research strategy is divided in quantitative or qualitative (David & Sutton, 2011, p.81). One can define quantitative research as a strategy focused on quantification of hard and reliable data, including their structured collection and analysis in an artificial setting (Bryman & Bell, 2011, pp.26; 412). Quantitative research is often associated with a deductive approach, the application of a natural science model by following a positivistic approach and an objectivist view of society. The research is guided by the researcher’s point of view, which takes over a distant role and aims to investigate a static image of the social world with a generalizable output. In contrast qualitative research aims to describe and understand the context and process of the social world in a natural setting. This is studied allowing for a flexible and limited structure (Bryman & Bell, 2011, pp.402-411). Focused on an inductive approach, it aims to build theory while following interpretivism and constructionism as the researcher tries to gain an understanding of individuals and their social progress (Bryman & Bell, 2011, p.27). Thus, the research is driven by the point of view of the participants, while the researcher is at the same time involved in that social world (Bryman & Bell, 2011, p.410). The following table clarifies the fundamental differences:

Table 1: Fundamental differences between quantitative and qualitative research strategy.

<table>
<thead>
<tr>
<th></th>
<th>Quantitative</th>
<th>Qualitative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal orientation</td>
<td>Deductive; testing of theory</td>
<td>Inductive; generation of theory</td>
</tr>
<tr>
<td>of theory in relation to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>research</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Epistemological orientation</td>
<td>Natural science model, in particular positivism</td>
<td>Interpretivism</td>
</tr>
<tr>
<td>Ontological orientation</td>
<td>Objectivism</td>
<td>Constructionism</td>
</tr>
</tbody>
</table>

(Source: adapted from: Bryman & Bell, 2011, p.27).

Our research strategy is a qualitative study where we accept the differences between objects of natural science and individuals in the social world. The research purpose is best suited by a qualitative approach as we want to gain insight in the perceptions of micro-entities regarding voluntary audit and seek to understand the reasons behind their choices. We conduct semi-structured interviews with partly open questions as we are concerned with words and their meanings rather than numbers and quantities. The data collection process is less structured as we seek to gain contextual understanding of our subject matter, while giving detailed descriptions of the social world we study. Thus, we believe that qualitative interviewing is the sound method for answering our research purpose and questions.

2.8 Sample Selection

Selecting a sample is to decide who will be the exact object of your study (David & Sutton, 2011, p.237). Bryman and Bell (2011) defines a sample as “the segment of the
population that is selected for investigation”, while population is defined by “the universe of units from which the sample is to be selected” (Bryman & Bell, 2011, p.176). Before deciding on a sample one should create a sample frame where all existing units in the population are recorded. When looking for a sample it is favourable that the sample is representative, i.e. mirrors the characteristics of the population. It is important to keep in mind that a sample does not exactly represent the whole population as one always has to deal with an unavoidable difference between sample and population called sampling error. In general, there are two main sampling techniques: probability or non-probability sample. With a probability sample, the selection of the sample follows a random technique and each unit of the population has the same probability to be included in the sample. In contrast in a non-probability sample a non-random method is used when choosing the units and as a result some units have a greater likelihood to appear in the sample. Hence, probability samples are often accompanied by lower sample error than non-probability samples (Bryman & Bell, 2011, pp.176-179).

Probability sampling can further be divided into simple random sample, systematic sample, stratified random sampling and multi-stage cluster sampling. Simple random sample reflects an easy form of sampling where no unit is more or less likely to be incorporated in the sample (David & Sutton, 2011, p.228). In a systematic sample the researcher choose the units out of the sampling frame without using a table of random numbers (Bryman & Bell, 2011, p.180). Stratified random sample implies stratifying the population by a specific characteristic in which the population is known to differ before conducting a simple random or systematic sample from the determined strata (Royse, 2011, p.196). A multi-stage cluster sampling follows different steps of sampling, while grouping the units into called clusters and repeating the sampling at different levels (David & Sutton, 2011, p.231).

Non-probability samples distinguish between convenience, snowball and quota sampling. Convenience sampling is applied when the researcher does not want to risk missing data or wants to pilot a research instrument because the sample concentrates on easy accessible participants. Snowball sampling means that the researcher contacts a number of suitable participants who then use their networks to spread the research among others (Bryman & Bell, 2011, pp.190; 192). Quota sampling tries to make sure that the sample covers the population by certain proportions of different pre-defined characteristics (David & Sutton, 2011, p.231).

The sampling methods introduced above are more commonly used in quantitative research. In qualitative research it makes sense to distinguish between purposive and theoretical sampling. Purposive sampling is a non-probability sample method where cases/participants are sampled in a strategic way and the researcher focuses on a sample that is best suited to the research purpose (David & Sutton, 2011, p.232). Theoretical sampling is summarized as “the process of data collection for generating theory whereby the analyst jointly collects, codes, and analyzes his data and decides what data to collect next and where to find them, in order to develop this theory as it emerges. The process of data collection is controlled by the emerging theory, whether substantive or formal” (as cited in Bryman & Bell, 2011, p.443).

In our study we apply a purposive sample as we already have certain criteria in mind regarding our research purpose and question. We are aiming to interview micro-entities in a predefined regional area, namely Skellefteå, we must seek for respondents that fit
those criteria. Hence, we have pre-defined sample groups in mind when looking for relevant companies. Due to the issue of generalization we first wanted to conduct homogenous purposive sample, where we would have examined micro-entities in the same business area but due to the lack of time, we will conduct a heterogeneous sample, which means that we include micro-entities of different business areas and aim to investigate their different viewpoints and perceptions.

We use convenience sampling for the choice of the regional area as we examine companies in Skellefteå. This is due to time and cost limits as we are both students in Umeå and close proximity is important for us. Due to the high student concentration in Umeå we thought it would be easier to find participating companies in Skellefteå as there are less theses and projects being conducted there. Additionally, we believe that relationship factors are more significant in a smaller town. We are aware of, and concerned with, the issue of generalization and external validity as a convenience sample is rarely a representative sample. We have contacted the firms which are available for our study and even though they might not be representative for the entire population of micro-entities in Skellefteå we have tried to have an as random sample as possible to reduce sample error. We think that our convenience sample can give incentives for further research. Moreover, we conducted a qualitative study where we try to gain a rich and deep contextual understanding of a social setting rather than being concerned with a great quantity of data and generalization.

To choose our sample, we started by looking at the entire population of micro-entities in Skellefteå. We found this in the database Affärsdata, which we accessed through Umeå University. In the search function, we selected only active limited companies based in Skellefteå and that had maximum 5 employees, to ensure that we also could find companies that had more than 3 employees, which is one of the three criteria to be exempt from audit, but still were below the upper limits of the other two criteria (turnover of maximum 3 MSEK and assets of 1.5 MSEK). There were 1569 companies that fit the search. Due to our limited knowledge of the database, we could not create a complete list of exempt companies. We had the results that show turnover and only looked closer at companies with a turnover under the limit. We did not go through every page as there were far too many companies, but instead chose page numbers with a random number generator. While assembling the list of companies that fulfilled the exemption requirements, we did not look at any other factors but if they were exempt (such as industry, age of company, auditor status).

2.9 Data Collection
One can distinguish between two kinds of data in business research: primary and secondary data. Secondary data has already been collected for the purpose of other research and can be either raw or compiled data. When a researcher aims to collect new data for his/her research purpose, that data is primary data. One approach to collect primary data is observations, either participant observations or structured observation, which is particularly useful when a researcher aims to understand what people do. Primary data collection is also possible through interviews, where the researcher has the choice between unstructured, semi-structured and in-depth interviews. Possible forms of these interviews are face-to-face, telephone or focus group interviews. The choice of how to collect primary data highly depends on the research purpose and overlapping data collection approaches are possible (Saunders et al, 2009, pp.256-321).
The data used in this thesis is both primary and secondary data. The research question and purpose as well as our motivation for this study is based on previous research and literature from various sources, such as journals, books, articles, laws and regulations as well as further relevant electronic and printed publications. The majority of our secondary data is collected through the Umeå University library database, mainly Business Source Premier and through the search engine Google Scholar. The keywords used for our search are as follows:

- Agency theory, audit demand, auditor-client relationship, audit exemption audit in SMEs, auditing in Sweden, audit regulations, business relationships, micro-entities, non-audit services, relationship marketing, role of auditor, service-relationships, voluntary audit.

The aim of using secondary data is to refine our research purpose and background knowledge to create a better study. Furthermore, we are able to ensure great data coverage and well based research for the thesis which enables us to build our interview questions on secondary data.

To fulfill our research purpose and interest in the richness of data in a particular social setting, we also collect primary data as we explore a relatively new phenomenon. We conduct semi-structured, face-to-face interviews for gathering primary data. The respondents are owners or managers of various micro-entities in Skellefteå. We use a qualitative interview technique to obtain personal and rich data which reflect the perceptions and opinions of the participants. To ensure the exploratory part of our study we start our interviews with open questions to give the participant room to unguided present their own thoughts as well as create a foundation for new upcoming discussions during the interviews.

After we had collected a list of 50 companies with contact information to the registered owner according to the description in section 2.8, we called each company to try and book an interview. 12 (24 per cent) companies agreed to be interviewed, 13 (26 per cent) declined to be interviewed and the remaining 25 (50 per cent) could not be reached even after several attempts. All interviews were to be face-to-face, but due to illness one (AU2) was done by phone. One interview was cancelled as we could never get a hold of the company to schedule the interview after the initial contact. After the data was collected, we placed the respondents into three groups based on auditor status. The AU group has retained their auditors; the NA group has dismissed or will dismiss their auditor during 2012 and the WA group was started after the exemption legislation was passed and has therefore never had an auditor.

2.10 Data Analysis

Qualitative data is deep and rich which makes it rather difficult to find a straightforward analytic path. In general, there exist two main strategies for analyzing qualitative data; analytic induction and grounded theory. Analytic induction starts with a broad definition of a research question and tries to find hypothetical explanations. When collecting the data and finding it inconsistent with the hypothesis, the researcher revises or reformulates the hypothesis, so that all cases fit the hypothesis (Bryman & Bell, 2011, pp.571-575). Grounded theory is defined as “theory that was derived from data systematically gathered and analyzed through the research process. In this method, data collection, analysis and theory stand in close relationship to one another.” (Strauss &
Corbin, 1998, p.12). Hence, data is used to develop theory and data and theory refers constantly to each other. Grounded theory is thereby a reiterative approach (Bryman & Bell, 2011, p.576).

This thesis uses grounded theory. The outcomes of grounded theory research are concepts, categories, properties, hypotheses and finally theory. We will maintain a close connection between data and conceptualization, so that we can draw conclusions about the correspondence between concepts and categories including indicators. In our study we will try to look for concrete concepts of reasons why micro-entities choose voluntary audit. While collecting and analyzing the data, we are open for changes of direction in our research and the relevant theory. For our analysis we apply coding, in particular open coding, which means we examine, compare, conceptualize and categorize data (Bryman & Bell, 2011, p.578).

2.11 Quality Criteria

According to Bryman and Bell (2011) there are three main criteria in business research: reliability, replication and validity. Reliability asks whether the chosen gauge measures the relevant concepts. Replication pays attention to how well a study can be reproduced and validity questions the integrity of the conclusions drawn from the research. It is often argued that these criteria are more relevant for quantitative studies than for qualitative studies (Bryman & Bell, 2011, pp.41-43). As a result researchers have introduced alternative criteria for qualitative research: trustworthiness and authenticity (Bryman & Bell, 2011, p.395). As our thesis carries out a qualitative study, we will verify the following criteria for our study:

Credibility finds that research should be carried out in a good way and the findings should be submitted to the participants so that they can confirm that the researcher has understood their social word in the correct manner. This respondent validation is important as it ensure credibility of the findings (Bryman & Bell, 2011, p.396). We can increase the credibility of our study by conducting all interviews and analysis in the same manner. The initial open questions also add credibility as we are not steering the respondents in any way. We will also ask confirming questions when uncertain about the meaning of replies so that we can ensure a high degree of credibility. In addition, we will record and transcribe the interviews to assure that no misinterpretations or misunderstanding has occurred.

Transferability asks to what degree findings can be transferred to other social settings (Bryman & Bell, 2011, p.398). As our study is limited to Skellefteå, the findings have less transferability. Nonetheless, we try to fulfill this criterion by providing the geographical setting and rich description of our research objects and method, so that one can draw own conclusion about transferability. As we protect the anonymity of our respondents, we only reveal identifying details if they are relevant to the results. This also lessens transferability, but might make the respondents more open and honest in their answers.

The dependability criterion suggests using an ‘audit approach’; detailed records of the research process are made available to others. Peers can then review the procedures and judge the appropriateness of the procedures used (Bryman & Bell, 2011, p.398). In this study, we disclose the sample selection process, data collection methods, interview
questions and the responses of our participants to increase reliability respective dependability in our findings.

Keeping in mind that a complete unbiased study ignoring the researcher’s values and inclinations is impossible, the researcher should nevertheless assure that he or she has followed good practice and faith (Bryman & Bell, 2011, p.398) by making sure the study is confirmable. We are concerned with our study’s conformability as we know that the sample choice of was carried out in a more or less subjective manner. Regarding our interviews we already have possible responses in mind, and need to be cautious not to guide the respondents to specific answers. By constructing neutral interview questions and letting the respondents answer in their own way without too much prompting, we try to reduce the risk of guiding.

In addition to the criteria above, authenticity criteria should be taken into account when conducting qualitative research. As these criteria are quite controversial and not widely influential, we will only cover them shortly. Fairness asks if the study reflects various viewpoints. Ontological authenticity helps people gain a better understanding of their social world, while educative authenticity helps them accept perspectives of other people. Catalytic authenticity is concerned with whether or not the study has encouraged people to change their surroundings and tactical authenticity questions if the research has given people the ability to engage in action. These criteria are concerned with the possible political impact of studies (Bryman & Bell, 2011, pp.398-399). Regarding our research, it is unlikely that we can achieve a wider political impact. Nevertheless, we can say that this thesis will be accessible at the Umeå University database as well as we will provide the results to the participants of the study, by which we attempt to contribute to a better understanding of the research topic in society and might give some impetus for changes.

2.12 Ethical Considerations

Ethics are a crucial point in all kind of research and have to be taken into account during various steps of the research process (Bryman & Bell, 2011, p.122). According to Royse (2011) ethics deal with issues regarding voluntary participation, harm to participants, well-informed participants and the protection of sensitive information.

As we conduct qualitative interviews, we aim to collect deep data from our respondents. We might therefore obtain sensitive information including personal opinions. Thus, we have to assure a high level of confidentiality and ensure that the respondents remain anonymous. We publish neither personal names nor company names and all other information must be assessed to see if it is relevant to the results before we decide to include it to reduce the possibility of identifying the participating micro-entities. We also accept that some respondents might refuse to answer certain questions and will not ask questions which delve too deep in private matters. We also thoroughly inform our participants about the purpose and reasons for the study and provide information about ourselves.

With regard to plagiarism, copyright, reciprocity and trust we also assure that all secondary philosophies and data is well cited and referenced and not marked as our own thoughts and opinions.
Chapter 3: Literature Review

This chapter introduces and summarizes previous literature that is relevant for our study. The literature builds a foundation for the design of the rest of the study as well as the basis for the analysis of empirical data. Furthermore, we make certain assumptions about how the results from the previous studies will differ from our study on micro-entities. As the research on relationship marketing has not been on SMEs or voluntary audit we have added a section that clarifies the connection between our topic and relationships.

3.1 Demand for Audit

3.1.1 Purpose of Audit

Companies prepare financial statements that are “recording, classifying, and summarizing of economic events in a logical manner” (Elder et al., 2010, p.6), however, there also exists a need to verify that the information presented in the financial statements is correct (Elder et al., 2010, p.8).

According to Eilifsen et al., (2010) auditing is “a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users” (Eilifsen et al., 2010, p.10). To properly conduct an audit, there should be recorded financial information that the auditor can investigate by referring to a certain standard (Elder et al., 2010, p.4). The auditor must be able “to obtain a sufficient quality and volume of evidence” to serve the purpose of auditing (Elder et al., 2010, p.5). The auditor then issues an audit report where s/he states an opinion of whether the financial statement complies with the relevant standard (Elder et al., 2010, p.9). Consequently, the auditor provides a judgment about the accuracy of the statements regarding to material respects, financial position, results of operations and cash flows. This ensures that the company has prepared the financial statement according to the national or international accounting principles (Elder et al., 2010, p.142). Auditing therefore seeks to provide third party assurance, in particular to ensure that legal objectives are met and it also creates a requirement for managers to justify their economic actions to the public (Malagueño et al., 2010, p.373). The manager should be held accountable to the shareholders (Eilifsen et al., 2010, p.6). Moreover, auditing enhances monitoring and control functions for shareholders (Solomon, 2010, p.183).

To summarize, the purpose of auditing is to create transparency, accuracy and comparability for shareholders, stakeholders or other interested readers of financial statements (Malagueño et al., 2010, p.372). Hence, audited financial statements add credibility for the public and reduce information-, inherent- and control risks. The idea of auditing does not imply that an auditor provides absolute assurance about the accuracy of a financial statement but rather a reasonable assurance that the statement reflects “true and fair value” (Solomon, 2010, p.183).

3.1.2 Agency Perspective

The agency theory was first mentioned by Jensen and Meckling (1976) who classified an agency relationship as “a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which
involves delegating some decision making authority to the agent” (Jensen & Meckling, 1976, p.308). Generally, the principal is the owner and the agent the manager of a company. Assuming agents act rationally and strive for their own advantages; it is obvious that conflicts of interest exist. As a solution Jensen and Meckling suggested providing incentives for the agent to reduce agency costs resulting from the separation of ownership and management. Agency costs are the monitoring expenditures by the principal, the bonding expenditures (incentives) for the agent and the residual loss, incurred due to the different decisions made by the agent. Thus, agency costs never equal zero (Jensen & Meckling, 1976, p.308).

The separation of ownership and management leads to an information asymmetry as the manager knows the exact financial position of the company whereas the owner must rely on the manager’s information (Eilifsen et al., 2010, p.6). Auditing can therefore reduce agency costs by increasing and ensuring the credibility and correctness of financial reports prepared by the agent due to an independent outside control, namely the auditor (Seow, 2001, p.62).

The following figure explains the demand for auditing from an agency perspective.

Figure 1: Demand for auditing from an agency perspective. (Source: Adapted from Eilifsen et al., 2010, p.7).

3.2 Audit Regulation

The agency perspective shows that auditing is a tool to ensure reliability of financial reporting as outsiders of the firm do not have the same information as management and auditors do (Eilifsen & Willekens, 2008, p.10). It is necessary that auditors follow audit
regulation and laws to increase confidence in their work (Chambers, 2006, p.43; Eilifsen & Willekens, 2008, p.9). As it is not in the scope of our thesis to provide a detailed overall view of audit regulations we will only deal with the most important laws and regulation in reference to the content of our research.

### 3.2.1 Audit Regulation Worldwide

As audits play an important role in most economies, regulatory and governmental involvement has characterized the audit environment (Eilifsen et al., 2010, p.42). Scandals at the beginning of the 21st century (e.g. Enron and Parmalat) caused far-reaching actions to be taken regarding regulations by various governments and stressed the role of credible auditing. For instance, the Sarbanes-Oxley Act of 2002 required auditors of listed companies in the US to be overseen by an independent regulator, i.e. the Public Company Oversight Board (PCAOB) (Eberle & Lauter, 2011, pp.436-437). In Europe, the European Commission has introduced the European Group of Auditor’s Oversight Bodies (EGAOB) as a counterpart to the American PCAOB (European Commission, 2005a).

From a global perspective, the International Federation of Accountants (IFAC) and the International Auditing and Assurance Standards Board (IAASB) were created to guide and improve international accounting and auditing standards in order to enhance quality and serve the public interest (IFACa, 2012; IFACb, 2012). Their International Standards on Auditing (ISAs) have become one of the most established standards worldwide (IFACc, 2012; Eilifsen et al., 2010, p.42).

### 3.2.2 Accounting regulation in the European Union

The Fourth Company Law Directive (78/660/EEC) from the EU is an important directive that attempts to harmonize the international accounting and auditing standards as it requires all non-dormant limited companies to draw up annual accounts and have them audited. Article 11 and 27 describe which companies can draw up limited annual accounts. These are companies that do not exceed criteria regarding balance sheet, turnover, and average number of employees (European Economic Community, 1978). Small companies can be exempted from audit by not exceeding two of the following criteria:

i) Balance sheet total: 4.4 MEUR  
ii) Net turnover: 8.8 MEUR  
iii) Number of employees: 50 (on average)

However, it is important to keep in mind that the member states can decide about lower thresholds, which means that there are a number of different thresholds in the European countries (Collis, 2010, p.213).

In February 2009 a proposal for the Directive of the European Parliament and of the Council amending Council Directive 78/660/EEC was made regarding micro-entities (European Economic Community, 2009). In December 2011 the European Parliament formally approved an amendment to Directive 78/660/EC and micro-entities can now have even less accounting requirements when not exceeding more than one of the following criteria:
i) Balance sheet total: 350 000 EUR
ii) Net turnover: 700 000 EUR
iii) Number of employees: 10 (on average)

The reason for this was to decrease the administrative burden and allow for competition and growth (European Parliament, 2011).

### 3.2.3 Audit and Accounting Regulation in Sweden

The Swedish Accounting Standards Board (Bokföringsnämnden, BFN) is a government organ that aims to develop generally accepted accounting principles (god bokföringssed) in Sweden. Two of the most important frameworks are the Annual Account Act (Årsredovisningslagen, ÅRL, SFS 1995:1554) and the Bookkeeping Act (Bokföringslagen, BFL, SFS 1999:1078). The former is included in the EC Fourth, Seventh and Eleventh Directives (BFN, 2012). As BFL (SFS 1999:1078) is not applicable for joint share companies, one must look to the Joint Share Company Act (Aktiebolagslagen, ABL, SFS 2005:551, 1:12 a) to find that ÅRL (SFS 1995:1554) holds the accounting laws for joint share companies. In addition to BFN, the Swedish Financial Supervisory Authority (Finansinspektion) is a public authority in charge of the development of generally accepted accounting principles in regard with companies that operate in the financial markets (finansinspektionen.se). That BFN and the Financial Supervisory Authority are responsible for the development of generally accepted accounting principles is regulated in BFL (SFS 1999:1078, 8:1).

According to Westermark (2012) generally accepted accounting principles is an old Swedish concept, the meaning of which is continually discussed in accounting and legal communities. It is however a very important principle in Swedish accounting, mentioned in both BFL (SFS 1999:1078, 4:2) and ÅRL (SFS 1995:1554, 2:2) as a general guideline on how accounts should be kept and financial statements made. The generally accepted accounting principles is a legal standard and fills out the large gaps left by the framework legislation in accounting. However, even BFN that is supposed to be the developers of the principles have been divided and have given opposite opinions in the matter of what the principles should be based on: the legal proposition (förarbete) or custom (Westermark, 2012, pp.112-123).

Financial statements and accounting for limited companies is regulated in chapter 2-6 of ÅRL (SFS 1995:1554) and have to be made public according to the rules in chapter 8. Previous to the fiscal year of 2011 the financial statements of all limited companies had to be audited according to the ninth chapter of ÅRL, but with the law change (SFS 2010:834) this is no longer the case. Private limited companies can now choose to not have an auditor if they do not exceed the maximum of more than one criterion in the third section of chapter 9:1.

SFS 2010:834 came into action on November 1st, 2010, and provides the opportunity for micro-entities to choose whether or not to have an auditor in the company. This amendment to ÅRL (1995:1554) does not mean that the format or regulations for the financial statement changes, just that the company can choose not to have them audited. The companies have to actively choose at the general annual meeting to dismiss their auditor and change the articles of association to say that they do not have an auditor in the company. This change has to be reported to Bolagsverket (Swedish Companies
Registration Office), and registered before the start of the fiscal year to be applicable for that fiscal year. The year where the company chooses to dismiss their auditor must still have audited financial statements (Regeringskansliet, 2010).

The thresholds for audit in limited private companies in Sweden are

i) Balance sheet total: 1.5 MSEK
ii) Net turnover: 3 MSEK
iii) Number of employees: 3 (on average)

If the company has exceeded two or more of the threshold values during the past 2 years, they are mandated by law to have an auditor. If a corporate group exceeds the values, at minimum the mother company must have an auditor (Regeringskansliet, 2010). As we stated previously, the thresholds for mandatory audit can be set by the member countries themselves, if they do not exceed the thresholds set by the EU, and as seen above the Swedish threshold values are quite low in comparison with the EU. This is one of the reasons why we believe that the previous research on voluntary audits in SMEs will differ from our findings.

3.3. Definition and Significance of Small- and Medium-Sized Entities (SMEs)

Small- and medium-sized entities (SMEs) account for 99 per cent of companies worldwide and for 99.8 per cent of firms in the EU. As there are 20.9 million SMEs in the EU and two out of three employees (or 66.7 per cent of the employed workforce) in the EU are employed by a SME it is obvious that SMEs play a significant role in the global economy (Eurostat, 2011, p.11; Vasek, 2011, p.115).

Even though SMEs account for a majority of companies worldwide there is no general accepted definition of what exactly characterizes a SME, neither is there a clear differentiation between micro-entities and small firms. Definitions differ between industries but they all refer to certain criteria such as number of employees, assets, sales, turnover or production capacity. For instance, a quite common view is that SMEs have less than 100 employees (APEC Profile, 2003, pp.173-175).

The International Accounting Standard Board (IASB) define SMEs as entities that “do not have public accountability” and “publishes general purpose financial statements for external users” (IASB, 2010, p.3; Vasek, 2011, p.117). The former includes that the entities securities are not publicly traded and that it is not a financial institution, the latter refers to financial statements that are prepared for stakeholders. These stakeholders include lenders, creditors, investors, employees, government and other outsiders, while the government and regulators confine the companies which are channelled into the framework (IASB, 2010, p.3).

The European Commission characterizes SMEs by using the number of employees as the main criteria and adding either turnover or balance sheet total as an additional criteria. According to the Commission recommendation, turnover cannot be the only criteria for defining an SME as different industries such as the trade and distribution sectors are accompanied by a greater turnover than firms in the manufacturing sector. Balance sheet total is used to measure the companies’ wealth (Commission of the European Communities, 2003).
The European Commission makes use of the following division:

Table 2: Definition of SMEs.

<table>
<thead>
<tr>
<th>Company category</th>
<th>Employees</th>
<th>Turnover</th>
<th>or</th>
<th>Balance sheet total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium</td>
<td>&lt; 250</td>
<td>≤ 50 MEUR</td>
<td>≤ 43 MEUR</td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>&lt; 50</td>
<td>≤ 10 MEUR</td>
<td>≤ 10 MEUR</td>
<td></td>
</tr>
<tr>
<td>Micro</td>
<td>&lt; 10</td>
<td>≤ 2 MEUR</td>
<td>≤ 2 MEUR</td>
<td></td>
</tr>
</tbody>
</table>

(Source: European Commission (2003)).

In addition, the Commission restricts the definition of an SME to a holding limit of 25 per cent. This refers to public bodies as well as other controlling entities (Commission of the European Communities, 2003).

The majority of companies in the EU are micro-entities as they make up 92.0 per cent of the total number of companies, followed by small enterprises with 6.3 per cent and medium-sized enterprises with 1.1 per cent. The percentage of large enterprises in the EU is only 0.2 per cent (Eurostat, 2011, p.12). For Sweden these numbers are:

Table 3: Number of Swedish companies divided by size.

<table>
<thead>
<tr>
<th>Company Size</th>
<th>Employees</th>
<th>Share</th>
<th>Number of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big</td>
<td>&gt; 250</td>
<td>0.1 %</td>
<td>945</td>
</tr>
<tr>
<td>Medium</td>
<td>50-249</td>
<td>0.5 %</td>
<td>4 727</td>
</tr>
<tr>
<td>Small</td>
<td>10-49</td>
<td>2.9 %</td>
<td>30 242</td>
</tr>
<tr>
<td>Micro</td>
<td>1-9</td>
<td>21.0%</td>
<td>217 338</td>
</tr>
<tr>
<td>One-man business</td>
<td>0</td>
<td>75.6%</td>
<td>783 535</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>1 036 787</td>
</tr>
</tbody>
</table>

(Source: Ekonomifakta (2011)).

Thus, we can see that micro-entities including one-man businesses have an above average representation in Sweden, which emphasizes their importance for the Swedish economy. It is important to note that there are many varying definitions of SMEs and micro-entities which can be misleading.

**Business Factors**

**3.4 Voluntary Audit in SMEs**

As seen above, auditing plays an important role in the economic context of companies. As EU regulation allows the member states to exempt SMEs and micro-entities from having their financial statements be audited (Fourth Company Law Directive 78/660/EEC), we now consider aspects which are related to the choice of voluntary audit.

Audits are always accompanied by costs as an external auditor needs to be engaged and paid for the review of the accounts. Therefore, one can ask why exempted firms nonetheless would conduct an audit.
The following sections review previous studies and their findings regarding different drivers in the choice of voluntary audit and provide an outline of the expected findings for our study.

3.4.1 Firm Size and Separation of Ownership and Management

Greater firm size is often accompanied by a separation of ownership and management, and the demand for audit is also higher as firm size increases which a study by Collis et al. (2004) confirms. Collis et al. (2004) measured the size of the companies by turnover, balance sheet total and/or number of employees, by which the authors wanted to investigate the use of size criteria for audit exemption legislation. Their sample in the UK included 66 per cent family owned firms and 82 per cent of firms had one to four shareholders. The authors conclude that turnover was the only measure positively related with the choice of a non-mandatory audit. This indicates that cost-benefits of audit play an important role for companies (Collis et al., 2004, pp.90-95). Hay and Davis (2004) also found a positive correlation between firm size and audited financial statements when they investigated the choice of voluntary audit in incorporated societies in New Zealand. Consistent with agency theory they suggest that the following factors correspond to the choice of voluntary audit: monitoring (principal monitors the agent) and bonding (principal gives incentives to agent), signaling (the agent conveys plausible information about himself to the principal), insurance and organizational control (Hay & Davis, 2004, p.40). Whereas signaling and insurance might be more related to the amount of debt, which we will discuss later, the demand for monitoring and bonding as well as organizational control result from firm size and separation of ownership and management.

In-Mu et al. (2008) examined the voluntary audit of interim reports in China and confirms the findings of Collis et al. (2004) and Hay and Davis (2004), showing that firm size is positively correlated to the choice of voluntary audit. In general, the authors found that the audits of interim report have increased from 13.7 per cent in 1996 to 30.6 per cent in 1999, of which 23.8 per cent were voluntary audits (In-Mu et al., 2008, p.75). As in Collis et al. (2004) the authors also provide evidence that more profitable firms, as measured by return on assets, are more likely to choose to have their financial statements audited. Furthermore, Allee and Yohn (2009) argue that not only is firm size related with the demand for financial statements but they also provide evidence from the United States that a high number of business sites are associated with the choice of an audit due to greater complexity. Specifically, they conclude that companies that let their financial statements be compiled, reviewed and/or audited by external professionals are 2.7 times bigger and have 13 per cent more business sites than firms that decide not to have their financial statements checked (Allee & Yohn, 2009, p.8).

In contrast, Carey et al. (2000) did not find any support for correlation between firm size and external audit demand. Instead they provide evidence from Australian family-run businesses that the demand for audit is positively correlated with the separation of ownership and management. This was measured by the proportion of non-family management in the firm as well as the proportion of non-family representation on the board of directors, both being typical characteristics of family businesses. Both factors are connected with the delegation of responsibilities accompanied with the need for control and monitoring and were the main drivers for engaging an auditor. In total 46 per cent of the family firms in the sample made use of auditors (Carey et al., 2000, pp.
39-45). Consistent with agency theory Jensen and Meckling (1976) and Watts (1977) found that firms are likely to prepare and audit financial statements in order to reduce the agency conflicts. By doing so, the actions of the agent, e.g. the manager, are not accompanied by the performance of final control, which allows a separation of management and control (Fama & Jensen, 1983, p.304). These results are consistent with Collis et al. (2004), who found evidence for the significance of agency relationships regarding the choice for voluntary audit, especially when companies were not completely family-owned. Hay and Davis (2004) also discuss agency costs as a driver for the demand for audited financial statements and found that lower managerial ownership is positively correlated with the choice of voluntary audit. Tabone and Baldacchino (2003) conducted interviews with owner-managers of small companies in Malta and argue that the agency conflict does not exist to any extent in manager-owned companies as the shareholder has first-hand knowledge of the business.

In our focus on Swedish micro-entities, we might not find a complex separation of management and control as micro-entities are quite small companies with few employees and owners. They may even be one-man companies with a simple organizational structure, but in order to cause an agency conflict it can be sufficient to simply have a separation and delegation of tasks (Schulze et al., 2001, p.100). A principal in a small firm can be defined as anyone that is not close to the management, for instance an external shareholder, lender, someone who extends credit to the company or somehow has an interest in the company (Collis et al., 2004, p.89). Niemi et al. (2012) found that there is an increase in outsourcing accounting functions in small Finnish firms, which introduces a new phenomenon of information asymmetry; between the external accountant and the company. Hence, we can expect that agency conflicts in micro-entities are more concerned with control mechanisms between external parties and the micro-entity, rather than within the entity itself. In addition, small firms often lack internal control systems, which also increase the need for external checks and controls (Abdel-Khalik, 1993, p.38). This is consistent with the suggestions of Fama and Jensen (1976) for decreasing agency conflict, specifically decisions hierarchies, mutual monitoring systems and board of directors. These are most likely uncommon features in small firms; thereby the risks of agency conflicts could increase in those entities. However, regarding the small size of our sample firms, we can expect that the demand for auditing is low when considering firm size as a determinant.

3.4.2 Amount of Debt
Chow (1982) provides early evidence that the choice of voluntary audit depends on leverage and accounting-based debt covenants. Under those circumstances, shareholders are more likely to transfer wealth from the bondholder which is accompanied by a greater demand for audit (Chow, 1982, p.275). Carey et al. (2000) as well as Hay and Davis (2004) found consistent evidence for a positive correlation between the amount of debt and voluntary audit in Australia and New Zealand, indicating that external auditors have a monitoring function that aims to increase credibility of the financial statement. Hay and Davis (2004) argue that the signaling and insurance effect of an audited financial statement is especially important for companies with a high amount of debt to reflect their ability to cover possible losses (Hay & Davis, 2004, p.41). Allee and Yohn (2009) also provide evidence that firms that had their financial statement compiled, reviewed and/or audited by professionals purchased 70 per cent more trade credits.
Contrary to the above findings, Seow (2001) looked at debt structure of small companies in the UK and found no significant differences between companies regarding the choice of voluntary audit. In his sample 46.9 per cent of companies with debt engaged an auditor. Especially firms with secured debt chose to not audit their financial statements. In addition, he could find no difference in the demand for audit when looking at the age of the debt. These findings are inconsistent with the general assumption of the lender-borrower relationship in agency theory. However, when considering the amount of debt Seow (2001) also found that a high amount of debt is positively associated with the preparation of audited accounts. In addition, he provides evidence that lender demand was strongly associated with the demand for an audit (Seow, 2001, pp.71-74). Niskanen et al. (2009) also discussed the relationship between voluntary audit and firm leverage. This study was conducted on family-owned companies in Finland and found no significant correlation between the variables.

We can thereby conclude that the majority of previous studies found a positive correlation between amount of debt and demand for voluntary audit. However, there are still inconsistencies between the studies and we have to consider that the studies have rarely focused on Swedish or comparable environments. Furthermore, when we consider that micro-entities usually do not provide as much financial information as a larger or public firm and are accompanied by fewer assets (Seow, 2001, p.64), we assume that the increased credibility in audited financial statement that acts as a guarantee that the firm is still viable, is even more important for micro-entities.

3.4.3 Net Benefits

Blackwell et al. (1998) write that in general the likelihood of engaging an auditor for private firms depends on the expected net benefits. They found that that 37 per cent of the sample firms issued audited financial statements where the most significant benefit for companies with audited financial statements was that they pay lower interest rates to lenders than firms with unaudited financial statements do. Higher risk firms can thereby decrease their interest rates by auditing their financial statements. The authors argue that the benefit of lower interest rates can be up to 28 and 50 per cent of the audit fees (Blackwell et al., 1998, pp.58-67). In agreement, Kim et al. (2011) provide evidence for private Korean companies where audited financial statements were also accompanied by lower interest rates for loans. The authors concluded that firms who switch from non audit to voluntary audit achieved more interest cost benefits than companies that were mandated to switch to audit (Kim et al., 2011, p.587). The same result was attained by Lennox and Puttman (2011) in a natural experiment where they showed that companies that maintained the audit when it became voluntary could increase their credit ratings by nearly two points. Companies that did not continue with the audit faced a drop of nearly four points in their credit ratings. Net benefits were thereby to be had for companies that by audit assured that they were a low-risk company (Lennox & Puttman, 2011, p.1660).

There are indications that the choice of voluntary audit has a signaling effect for the credibility of the financial statement. But an audit also always creates costs, for instance audit fees, which increases the importance of the signaling effect as the voluntary audit measured by audit fees in general is not economically favorable for the companies (Kim et al., 2011, pp.588-589). In a study by Lennox and Puttman (2011) we find further evidence for the signaling effect, as the sample companies did not change their audit assurances when switching from mandatory audit to voluntary audit, but kept it.
authors thereby contribute to the discussion if mandatory audit conceals valuable information for investors, adding further emphasis on the signaling effect (Lennox & Puttman, 2011, p.1658). Hay and Davis (2004) could also find a greater credibility in audited financial statements of incorporate societies in New Zealand.

Chow (1982) argued that audited financial statements have an insurance effect for possible losses for the external financier. This is consistent with a study conducted by Allee and Yohn (2009), where the authors found that firms with a reviewed or audited financial statement have greater access to credits as well as lower costs of credit. Moreover, they state that there is no relationship between the preparation of financial statements and the admission of a credit. Hence, it is the effect of the audit is the determining factor for obtaining credit. The authors also found evidence that family owned firms have easier access to credits, but could not confirm why this was the case (Allee & Yohn, 2009, pp.5-22). Tabone and Baldacchino (2003) also contribute to the discussion by confirming the insurance effect as one of the main drivers for owner-managed companies in Malta. Collis et al. (2004) found that 63 per cent of small companies in the UK would continue having their financial statements audited even though they were exempt. This indicates that firms believe that the benefits of audit justify its costs. Particularly when considering good relationships with banks, firms were likely to carry the costs for an audit (Collis et al., 2004, pp. 87-96). Supporting these studies, In-Mu et al. (2008) found that companies in China with audited financial statements have a better earnings response coefficient due to increased credibility of their accounts for investors.

Personal factors also play an important role when considering net benefits. Seow (2001) established that the perception of the management regarding the benefits of an audit influences the choice of whether to have their accounts audited or not. The article stressed that managers regard both money and time when considering possible benefits of audit. In his sample, 86.7 per cent of the directors consider audited financial statements as useful. On the other hand, when the directors chose to not have their accounts audited 82.4 per cent named the costs as the main reason for their decision (Seow, 2001, p.71). Tabone and Baldacchino (2003) found that the audit is perceived by managers as a proof that they provide high quality financial information. Likewise, Collis et al. (2004) concluded that the director’s perception of the value of audit was one of the main factors for choosing voluntary audit. The directors consider voluntary audit a useful instrument for checking on their internal control, thereby decreasing inherent and control risks. This is especially relevant for small companies as their inherent and control risks are high. Thus, material misstatements are more likely to occur and are also more likely to go undetected on a timely basis when having an audit (Collis et al., 2004, p.97). Consequently, 74 per cent of the directors agreed that the main benefit of non-mandatory audit is a check on accounting systems (Collis, 2008, p.56). In addition, improved information was believed to be crucial for the decision of voluntary audit. This was also measured by the variable of education, which had positive influence on the managers understanding and perception of the benefits of an audit (Collis et al., 2004, pp.96-97). If managers did not have a higher education or accounting expertise, they failed to see the benefits of the audit process (Tabone & Baldacchino, 2003, p.396). It was found that these personal factors were even more significant for the choice of voluntary audit than size factors like turnover (Collis et al., 2004, p.96).
Allee and Yohn (2009) also state that the average education of the owner was a significant factor related to the choice of a voluntary audit. But contrary to Collis et al. (2004) they argued that when the owners had a higher education, they did not consider the net benefits of an audit as high. Due to their higher education, they had less need to rely on professional help to make their financial statements more informative and raising the credibility thereof (Allee & Yohn, 2009, p.17). Similarly, Tabone and Baldacchino (2003) found in their qualitative study about manager-owned companies in Malta that audit had a positive effect on the owner-manager and staff. They perceived the audit as an independent verification of the company, helping the manager and employees to gain a better understanding of the financial accounts as they often lacked accounting expertise. The managers also perceived the auditor as a business consultant who could improve the organization and operations of the company due to their expertise and experience (Tabone & Baldacchino, 2003, pp.395-396). These findings are confirmed by previous studies conducted by Gunter (2000), Keasey et al. (1988) and Power (1997). Hence, one can conclude that the less accounting expertise the owner-manager has, the more likely they are to hire an auditor and appreciate the benefits of audit. This might be especially true in micro-entities as the manager often may lack accounting knowledge.

Another expected net benefit for companies is the provision of non-audit services by the audit firm. Collis (2010) provides evidence that SMEs in UK and Denmark do not prepare their accounts themselves, but rather get help from an external accountant. Audit fees often cannot be estimated accurately because they include the costs for non-audit services. Marriott et al. (2006) found that the likelihood of engaging an auditor for SMEs is positively connected with the provision of non-audit services as the sample companies state that having the accounts prepared and audited by the same company is accompanied by lower costs. Furthermore, many companies in that sample considered the audit fee as insignificant when comparing it to the cost burdens of regulations or bureaucracy and the cost of other services (Marriott et al., 2006, p.22). This is consistent with other studies that investigate knowledge spillover factors when audit firms provide audit services as well as non-audit services. In particular, the provision of audit services and non-audit services at the same time can lead to economies of scale as this increases knowledge about the client and their specific business environment, thereby saving transaction and allocation costs and reducing start-up costs due to learning curve effects (Antle et al., 2006, p.240; Firth, 2002, p.168; Knechel et al., 2012, p.64).

As we can see from the discussion above, benefits of an audit can be inter alia economies of scale, supplement of non-audit services, reduced interests rates or a check on internal control. The cost of an audit can therefore reduce ex post costs such as monitoring costs. However, as the cost of an audit does not increase proportionately with the size of the firm; double firm size does not mean double of variable and fixed costs as set-up costs remain the same regardless of firm size (Chow, 1982, p.276; Keasey & Short, 1990, p.307). Our expectations for micro-entities are that the cost-benefit factors are among the crucial factors when deciding on voluntary audit. In addition, we expect that the lack of accounting expertise in micro-entities is a key driver for purchasing audit- as well as non-audit services for credibility and reliability reasons, especially in regard to signaling and insurance effects for third parties.
3.3 Relationship Factors

Section 3.3 presented a selected review of previous research in the rationale of companies to have voluntary audit. However, the motives presented there are mostly external and do not explore the dimension of auditor-client relationships. This section focuses on the components of relationships and at the end presents our expectations of relationship factors for the study.

3.5 Relationship Marketing

The notion that relationships are important in business is not new (Martin-Consuegra et al., 2006, p.99), but as a specified research field it is quite recent. According to Gumesson (2008) relationship marketing can be defined as “marketing that puts relationships, networks and interaction in the centre” (Gumesson, 2008, p.16) and talks about how relationships are basic in human nature and thereby exist in everything we do (Gumesson, 2008, p.22). The reason for engaging in relationship marketing is called Return on Relationships (ROR), and is measured by the duration of the business relationship and the retention rates of clients. The longer a company keeps their clients, the higher ROR (Gumesson, 2008, pp.267; 271-273).

Agariya and Singh (2011) reviewed the various definitions of relationship marketing during the past 30 years and found that the research community has not agreed on a general definition. Some of the central elements found in most definitions of the purpose of relationship marketing, relevant to our research direction, are the acquisition and retention of customers and having a long-term orientation (Agariya & Singh, 2011, pp.205-228).

Building blocks of relationships, or relationship marketing, are many. However, the most commonly cited according to Agariya and Singh (2011) are trust, satisfaction with previous experiences of the service provider, loyalty, commitment, service quality and communication.

To fulfill our research purpose we have focused on commitment and loyalty, these are the components that we expect to affect the decision of voluntary audit as loyalty and commitment to the auditor would be a motivation to stay in the relationship.

3.6 Benefits of Building Relationships in Business Contexts

Acquisition and retention of customers is basic for any business, as without customers the business will not survive any longer period of time. The first step to building a relationship is the awareness of the other party and the consideration that they might be a potential business partner (de Ruyter & Wetzels, 1999, p.58). One way for potential customers to be made aware of a business is by word-of-mouth, existing customers speaking favorably about the company. Villanueva et al., (2008) show that word-of-mouth has longer effect than traditional marketing on customer acquisition and that it is expected to bring in about the double amount of new customers (Villanueva et al., 2008, pp.54-55). Word-of-mouth is one of the benefits of having a personal bond with customers (Kuenzel & Krokolikowska, 2008, p.338), indicating that personal relationships have a positive effect on one of the basic principles of business.
de Ruyter and Wetzels (1999) found while studying a Big Four audit firm in the Netherlands that about 5 per cent of clients switch audit firms every year. Out of these, 35 per cent stated that their reason to leave was a poor relationship with the auditor. Furthermore, the better relationship between client and auditor, the less likely the client was to exhibit opportunistic behavior that would endanger the relationship for short-term gain (de Ruyter & Wetzels, 1999, pp.63-69).

Audit clients do not perceive a large difference in the quality of audits between different firms (de Ruyter & Wetzels, 1999, p.70), and it has been argued that contentment with the personal relationship to a service provider influences how the service itself is perceived (Gremler & Gwinner, 2000, p.91; Schakett et al., 2011, p.270). When the quality of the output is not a differentiating factor, it can be postulated that the personal relationship and satisfaction thereof is the deciding factor in changing or retaining an auditor.

As seen in the figure above, a personal connection and enjoyable interaction with the service provider leads to several positive effects. However, it is worth noting that “personal connection” and “enjoyable interaction” does not have to equal “friendship” in the traditional sense. Bäckström et al (2009) studied the differences between professional and personal relationships and found that there is a large difference between the two types.

The authors found that there was a significant difference between “good” and “bad” customers seen by the factors knowledge of goals, social network familiarity, physical intimacy and duration (Bäckström et al., 2009, p.36). This implies that a good professional relationship does have a positive impact on the business relationship. In chapter 4 (empirical findings) we specify how we define different types of relationship.

3.7 Building Blocks of Commitment and Loyalty

There are several different components of commitment and for the most part, researchers vary between two to four (Čater & Čater, 2010; Čater & Zabkar, 2009; de Ruyter & Wetzels, 1999; Shi et al 2009; Venelis & Ghauri, 2004) components of
commitment, whereas some go even further to five or more (Sharma et al., 2006). In this thesis, we will focus on 2 kinds of commitment, affective commitment and calculative commitment as these are the main types of commitment in the previous research, but also briefly touch upon the differentiation between positive and negative calculative commitment (Čater & Čater, 2010; Sharma et al., 2006).

Figure 3: Affective and calculative commitment. (Source: de Ruyter & Wetzel's, 1999, p.69).

3.7.1 Affective Commitment

Affective commitment is an attachment based on partiality and identification with the other party (Čater & Zabkar, 2009, p.785), including emotional attachment and social bonding to the other party. This kind of emotional commitment is built through interpersonal interaction where the parties want to develop the relationship (Sharma et al., 2006, pp.65-69).

As shown by the model above, there are significant links between service quality, interdependence, trust and affective commitment. The higher quality of service provided, the higher level of affective commitment (de Ruyter & Wetzel's, 2009, pp.68-70). As we mentioned earlier, the perceived level of service quality has been shown to be affected by the personal relationship with the service provider (Gremler & Gwinner, 2000, p.91) where Schakett et al (2011) found that 44 per cent of the variance found in service quality was explained by affective commitment (social bond), indicating a link between personal relationships and affective commitment.

The same relationship, albeit weaker (0.46-0.34) exists between trust and affective commitment in de Ruyter and Wetzel's study (1999). Trust has been defined as “the expectation that the [seller] will not behave in a manner that has negative or
opportunistic consequences for the [buyer]” (Schakett et al., 2011, p.271). Gounaris (2005) notes that a previously good service quality builds trust because the clients’ expectations were fulfilled.

The relationship between trust and affective commitment shown by de Ruyter and Wetzels (1999) is supported by Čater and Čater (2009) and Čater and Zabkar (2009). Clients who trust their service provider are more likely to enjoy the relationship and have a higher level of identification with the service provider, the same conclusion can be drawn from satisfaction with service quality and social bonds with the service provider (Čater & Zabkar, 2009, p.791).

A final component that shows a significant relationship to affective commitment in de Ruyter and Wetzels’s (1999) model is the interdependence between service provider and client. Again, the stronger sense of interdependence, the more it positively affects the relationship between the parties (de Ruyter & Wetzels, 1999, p.68).

Interdependence is a term that occurs in little of the research we have gathered, but similar concepts such as a combination of the terms co-operation, adaptation and knowledge transfers are frequent and seem to interact in the same way as in the model (Čater & Čater, 2009, pp.1154-1155). Some differences worth noting are that Čater and Čater (2009) divides affective commitment and pairs it with a concept called “relational benefits” which we feel is included in the other researchers definition of affective commitment. Furthermore, the term “co-operation” had by itself no significant effect or relationship with affective commitment (Čater & Čater, 2009, p.1163; Čater & Čater, 2010, p.1327). Venelis and Ghauri (2004) use the term interdependence as related to what we define as calculative commitment, which we will comment on in the next section, and de Ruyter and Wetzels (1999) mention that their results are contrary to others in previous research. Consequently, the concept should be given less weight compared to trust and satisfaction.

To summarize, we believe that trust, interdependence and satisfaction are the building blocks of affective commitment. Strengthening the argument are also the findings of Stanko et al. (2007), who found that mutual confiding (expected to find in a trustful relationship) and give-and-take services (that build an interdependent relationship) creates a stronger link to commitment. Emotional intensity was also shown to have an effect on commitment, much stronger than commitment based on behavior rather than emotions (Stanko et al., 2007, p.1101).

Several of the studies emphasized in their final recommendations that care should be taken both in hiring the right kind of social people to create this type of relationship with clients as well as being careful when relocating staff, as to not disturb existing relationships (Čater & Čater 2009; Gounaris 2005; de Ruyter & Wetzels 1999).

3.7.2 Calculative Commitment

According to both Sharma et al. (2006) and Čater and Čater (2010), calculative commitment has by some researchers been divided into both positive and negative parts, but the mainstream seems to use solely one characterization for calculative commitment, focused on the ‘negative’ calculative commitment. Čater and Zabkar (2009) defines the concept as a commitment “due to instrumental reasons” (Čater & Zabkar, 2009, pp.7855-7866) and Venelis and Ghauri (2004) as “the need to maintain a
relationship due to significant perceived termination or switching costs” (Venelis & Ghauri, 2004, p.1581). As seen in figure 3, de Ruyter and Wetzel’s model shows calculative commitment as a negative commitment, if the goal is customer retention, which is supported by Gounaris (2005) and Čater and Čater (2010), concerning negative calculative commitment.

Trust has been shown to influence affective commitment in a positive manner, but the opposite is true for calculative commitment (Gounaris, 2005, p.136) albeit the effect is not equally strong (de Ruyter & Wetzel, 1999, p.69). Satisfaction also affects calculative commitment in a negative manner (Čater & Zabkar, 2009, p.793; de Ruyter & Wetzel, 1999, p.69). When the perceived service quality is high and the clients satisfied with the results of the service, they spend less time calculating the benefits and drawbacks with the relationship at hand. As calculative commitment is based on “instrumental reasons” and the perceived difficulty of changing service provider, without the consideration of this kind of cost-benefit thinking there is little or no calculative commitment (Čater & Zabkar, 2009, p.793).

The last factor in figure 3 that affects calculative commitment is the service portfolio. A larger service portfolio was shown in the qualitative part of the de Ruyter and Wetzel’s (1999) study to be a “pleasant idea”, even though the client did not use the services, and reduces calculative commitment. The authors hypothesized that there would be a positive link between larger service portfolio and calculative commitment, but seemed satisfied with the results from the qualitative study explaining the quantitative result. They also postulate that the types of services are similar in all major audit firms, drawing the same conclusion as from the question of service quality: the large portfolio does not differentiate the firm or creates an instrumental reason to stay in the relationship (de Ruyter & Wetzel, 1999, pp.68-70).

### 3.7.3 Positive Calculative Commitment and Normative Commitment

Positive calculative commitment (termed cognitive commitment) is “value-based” as opposed to the negative (which we refer to as calculative commitment) that is based on the client being “locked” into the relationship (Sharma et al., 2006, p.69). The benefits included in the positive calculative commitment include direct profits, efficiency gains, information, referrals and resource access (Sharma et al., 2006, p.70). When including these factors in the term, it is not hard to understand how Čater and Čater (2010) connect for instance product quality and trust to positive calculative commitment. However, we feel that we have already addressed these benefits in the net benefits-section on business factors.

Venelis and Ghauri (2005) adds “stuck bonds” (contractual obligations and similar) to their model, and does not find a tie to calculative commitment even though most definitions of calculative commitment is the perceived difficulties with ending the relationship. They also hypothesize that trust would be related to calculative commitment as “trust can be regarded as an important relationship asset that would influence the customers’ perceived need to continue the relationship” (Venelis & Ghauri, 2005, pp.1589-1592), but found no such connection. The similarities between their view of calculative commitment and the positive calculative commitment begs the question if their model would not have been more informative, had they made that kind of distinction.
There is a strong correlation between the positive calculative and affective commitments (Sharma et al., 2006, p.80), which together with the connection of product quality and trust to the concept implies they are overlapping. In combination with the fact that most researchers have not made this distinction, it would be unnecessarily complicated to include positive calculative commitment into our study especially as it is mostly covered in the term ‘affective commitment’.

### 3.7.4 Antecedents to Loyalty

Čater and Čater (2009; 2010) define loyalty as a consequence of commitment and divide it into two subtypes, attitudinal and behavioral loyalty. Attitudinal loyalty is for instance positive word-of-mouth whereas behavioral loyalty is a continuance intention. Affective commitment accounts for 60.1 per cent of the variance in attitudinal loyalty and 44.9 per cent of the variance in behavioral loyalty (Čater & Čater, 2010, pp.1325; 1330). Consistent with those findings, Čater and Zabkar (2009) also found that affective commitment has a strong positive effect on loyalty and goes so far as to state that loyalty is to a large extent explained by affective commitment (Čater & Zabkar, 2009, pp.791;793). de Ruyter and Wetzels (2009) found no significant quantitative link between a client-oriented behavior and affective commitment, but the qualitative part of their study include statements from clients saying that “loyalty is a reward for client-friendly behavior” (de Ruyter & Wetzels, 2009, p.70).

Calculative commitment has in some studies been shown to have a negative effect on loyalty. For instance, de Ruyter and Wetzels (2009) found that calculative commitment has a relatively strong positive relationship with opportunistic behavior from the client (i.e. switching to another service provider due to lower fees), which in turn was shown to have a significant negative effect on continuance (behavioral loyalty) intentions. The opposite relationship was found with opportunistic behavior and affective commitment (de Ruyter & Wetzels, 2009, p.70). Gounaris (2005) also found a negative relationship between calculative commitment and relationship continuance intentions.

In conclusion, as we have chosen to use the ‘negative’ interpretation of calculative commitment, we find that the research is mostly consensual on its negative effect on loyalty and relationship intentions. The opposite is true for affective commitment, where the relationship with loyalty is strongly positive. We can therefore assume that the presence of affective commitment is a reason to stay in the relationship with the auditor, whereas calculative commitment is not.

### 3.8 Relevance of Relationship Factors

As Gummesson (2008) argues, relationships are part of everything we do, whether it is private or business. In a larger company with a higher degree of separation between ownership and management, or with more diverse ownership, we would assume that decisions that affect the company’s finances have to be motivated by hard facts rather than good relationships. In a micro-entity on the other hand, there are fewer (or only one) persons to consider the motivation behind decisions that affect the finances, such as auditor choice or choice of voluntary audit, and relationships might therefore play a larger role in such decisions.

The geographical location of our study is also material in relationship matters, as SMEs in Norrland have been shown to have a higher level of trust and commitment than companies in Stockholm as well as a stronger relationship overall to their auditor
Svanström and Boter (2012) also theorize that as there are closer relationships in Norrland between actors there might be more negative consequences in choosing to not have an auditor than there would be in Stockholm.

### 3.9 Summary of Previous Literature Findings

As seen from the previous literature, the demand for voluntary audit exists in companies that are exempt from statutory audit. Various determinants can influence the choice of non-mandatory audit. Considering business factor, agency conflicts in regard to both internal and external control are one main driver for engaging an auditor. Audit provides assurance within the firm as well as for interested outsiders, thereby increasing the credibility of financial information. Along with this are different benefits for the firms, such as easier access to credit, lower interest rates or economies of scale when using non-audit services from the audit firm. However, the perceived benefits can vary among firms and the determinants for non-mandatory audit might differ in regard to firm size.

The relatively new Swedish legislation (SFS 2010:834) of November 1st 2010 allows certain micro-entities to be exempted from statutory audit. As only little is known about audit in micro-entities our study will conduct a qualitative semi-structured interviews based on previous literature about SMEs and their determinants for voluntary audit. We believe that the underlying reasons for voluntary audit in micro-entities differ due to their specific business environment and size. Furthermore, previous literature suggests that relationship factors, such as trust, interdependence and satisfaction with service quality, are crucial for business relationships, which motivate us to look for possible connections between the choice of voluntary audit and the relationships between the business manager and the auditor.

### 3.10 Micro-Entities

As we began our research there were no studies about micro entities available, so the previous sections of our literature review are based on findings about SMEs. The first study about micro entities, that we are aware of, was published on March 30th 2012, its explanatory value to our findings induced us to add this section about micro-entities.

#### 3.10.1 Definition of Micro-Entities

As mentioned in Chapter 3, there is no generally accepted definition micro-entities. Therefore we make use of the definition by the European Commission as defined in 2003 which divides companies in medium-sized, small and micro by using number of employees and either turnover or balance sheet total (European Commission, 2003). With regard to this definition, micro-entities are companies that do not exceed the following criterion:

- Employees: < 10
- Turnover: $\leq$ 2 MEUR
- Balance Sheet total: $\leq$ 2 MEUR

This definition was the reaction of the European Commission to the increasing numbers of micro companies in the EU as a definition of micro companies was not included or considered previously (European Commission, 2005b, p.14). Hence, one can conclude that the European Commission appreciates the existence of fundamental differences
between SMEs and micro entities, which means that we can expect the findings in our study to differ from previous studies performed on SMEs.

3.10.2 Determinants for Voluntary Audit in Micro-Entities

The only study on voluntary audit in micro-entities is by Collis (2012) and was published on March 30th 2012 after we had conducted all interviews. Had this study been available to us previous to the interviews, we could have tailored the questions more towards micro-entities than to SMEs. Collis (2012) distinguishes between SMEs and micro-entities and their specific reasons to retain an auditor and found that 78 per cent of the micro-entities in the study chose to make use of the exemption.

In addition, Collis (2012) shows that micro-companies that have an external accountant that advises them were more likely to conduct a voluntary audit and concluded that the choice of voluntary audit is based on thoroughly considered decisions. Interestingly, the author could not find proof of external demands for an audit by major customers, suppliers or banks, even though the amount of assets or provided financial information by micro-entities often is low compared to larger companies. One would expect external business partners to require assurance that the financial statement is not materially misstated. In addition, no improvements in credit ratings were found in connection to voluntary audit, according to the perception of the directors (Collis, 2012, pp.12-20). One reason might be that business partners have other options to check the liquidity of a company. Flannery (2010) suggests that external parties can usually demand detailed financial information directly from the company. This is consistent with findings of John and Hearn (2000) who conducted semi-structured interviews in SMEs in the UK where some respondents from very small companies stated that suppliers or lenders always require more information than published financial accounts.

To summarize, Collis (2012) concludes that the decision to retain the auditor in micro-entities is determined by the following factors, in the order given: advice from the accountant, perception that the cost of audit is not a major burden, perceived demand from investors, turnover, perceived demand from banks/lenders and finally perceiving audit as a check on accounting systems and agency factors. In contrast, the study found that the most important factor for a voluntary audit in SMEs was turnover. In general, the author could conclude that small companies and micro-entities do not differ that much in their assurance and reporting needs, even though the order of the reasons behind the non-mandatory audit are likely to be different (Collis, 2012, pp.22-23).

As we see from the definition of the EU and Collis’ study there are some fundamental differences between the behavior of SMEs and micro-entities. Due to the fact that the size factor is crucial for the distinction between SMEs and micro-entities, we can indeed expect differences in regard with the expected outcome about drivers for voluntary audit when comparing it to the previous literature about SMEs that we reviewed in Chapter 3.
Chapter 4: Empirical Findings

This chapter presents the interview findings, without interpretation. All statements are replies from our respondents. To facilitate reading we have attempted that the disposition of the replies follows the literature review, which was the base of the interview questions. We have also divided the respondents into three groups, based on auditor status. AU group retains their auditor, NA group has dismissed their auditor and WA group has never had an auditor. To avoid leading respondents to specific replies, many answers are to open questions and more general in nature to fit our research philosophy of interpretivism. This also enhances the credibility of our research. The open questions leads to some repetition, as replies are used in different contexts. Further findings, unrelated to the literature review, are also presented.

Table 4: Overview of micro-entities included in our sample.

<table>
<thead>
<tr>
<th>Company</th>
<th>Founded/ Curr. Owner</th>
<th>No. Employees/ of which owner</th>
<th>Board Composition</th>
<th>Turnover</th>
<th>Short-term debt</th>
<th>Long-term debt</th>
<th>Education</th>
<th>Auditor dismissal</th>
</tr>
</thead>
<tbody>
<tr>
<td>AU1</td>
<td>2002/2002</td>
<td>1.5/1 Family member</td>
<td>Owner and close</td>
<td>2200</td>
<td>150</td>
<td>0</td>
<td>Folk high school</td>
<td>N/A</td>
</tr>
<tr>
<td>AU2</td>
<td>1993/2009</td>
<td>1/1</td>
<td>Owner and close</td>
<td>2800</td>
<td>550</td>
<td>0</td>
<td>Teacher’s degree</td>
<td>N/A</td>
</tr>
<tr>
<td>AU3</td>
<td>2005/2005</td>
<td>1/1</td>
<td>Owner and close</td>
<td>2500</td>
<td>440</td>
<td>0</td>
<td>2 year high school</td>
<td>N/A</td>
</tr>
<tr>
<td>NA1</td>
<td>2008/2008</td>
<td>1/1</td>
<td>Owner and close</td>
<td>560</td>
<td>130</td>
<td>30</td>
<td>High school</td>
<td>2011</td>
</tr>
<tr>
<td>NA2</td>
<td>1997/2006</td>
<td>2/1</td>
<td>Owner and close</td>
<td>1300</td>
<td>120</td>
<td>0</td>
<td>Engineer</td>
<td>2011</td>
</tr>
<tr>
<td>NA3</td>
<td>2008/2008</td>
<td>2/2</td>
<td>Both owners</td>
<td>520</td>
<td>60</td>
<td>0</td>
<td>High school</td>
<td>2012</td>
</tr>
<tr>
<td>NA4</td>
<td>2009/2009</td>
<td>1/1</td>
<td>Owner and close</td>
<td>420</td>
<td>60</td>
<td>0</td>
<td>High school</td>
<td>2012</td>
</tr>
<tr>
<td>NA5</td>
<td>2009/2009</td>
<td>2/2</td>
<td>Both owners</td>
<td>850</td>
<td>60</td>
<td>0</td>
<td>Engineer</td>
<td>2012</td>
</tr>
<tr>
<td>NA6</td>
<td>1990/2001</td>
<td>2.5/1*</td>
<td>Owner and close</td>
<td>1600</td>
<td>230</td>
<td>0</td>
<td>Vocational education</td>
<td>2011</td>
</tr>
<tr>
<td>NA7</td>
<td>2010/2010</td>
<td>2/2</td>
<td>Both owners</td>
<td>160</td>
<td>60</td>
<td>0</td>
<td>High school</td>
<td>2012</td>
</tr>
<tr>
<td>WA1</td>
<td>2011/2011</td>
<td>1/1</td>
<td>Owner and close</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>6 years post-high school</td>
<td>N/A</td>
</tr>
</tbody>
</table>

*One employee is a close family member

All financial numbers are from the last financial statement.

The table presents the micro-entities in our sample. It includes only factors relevant to the research purpose according to previous literature or our findings. We found no other aspects of the companies or owners that affected the choice of voluntary audit and therefore due to ethical considerations of anonymity we only include the above factors.

**Business Factors**

4.1 **Firm size and Agency Factors**

When asked about audit as an internal control mechanism, most of our respondents hesitated and stopped to think before giving replies in tentative voices.

Two respondents in the AU group, AU2 and AU3, could not answer the question as they had never thought about the function of audit and were not sure if internal control could be a function. AU1 considered an internal control mechanism as a generally
important function, but not in a small company like theirs as there is no separation of management and ownership.

Six of the NA respondents (not NA2) believed that internal control is an important mechanism of audit but added that internal control has more relevance in larger companies. NA3 emphasized that both owners are aware of what goes on in the company as they make all decisions together, and internal control is not necessary. NA7 thought internal control would matter more if they did not work with somebody they know and trust; there would then be a demand for control that they do not perceive now. NA5 and NA6 perceived the function of audit as an internal control mechanism in their companies as a relevant tool for controlling the accountant’s work. Furthermore, NA5 was the only company that spontaneously mentioned the internal control mechanism when asked about the general function of audit without being guided by a specific question. They perceived that the audit plays a crucial role in a big organization with diverse board composition where one is responsible for the organization. In that situation, NA5 found audit as an internal control check on the work of people you cannot directly control due to the complexity of the work and delegation of tasks. Only one company (NA2) was of the opinion that internal control is not an important tool of an audit regardless of firm size, number of employees or complexity of delegation of tasks.

The third group of respondents, WA1, believed that internal control is “useless” in their company as it only consists of one person. In general, they would find this function highly relevant in a large company as without control there would be “chaos”.

4.2 Amount of Debt, Credibility and Insurance Effects

No one in the AU group had any long-term debt. AU3 was the only respondent who had experienced that the bank did a thorough check of their business where they required various documents during a period when the business in AU3 did poorly. The auditor handled all bank contact and provided the necessary paperwork. AU3 therefore believed that banks care a lot if one has audited financial statements but would not say the same about suppliers. AU1 also replied that it is important to have audited financial statements as the tax office rewards this with greater confidence and less frequent checks. AU2 was surprised by the question as they have never thought that audited financial statement matter because they have never considered being without an auditor. AU2 could however imagine that auditor status is important for banks when a company has a high level of debt.

Out of the NA group, only NA1 had long-term debt, whereas the others only have short-term liabilities. Even though NA1 had long-term debt, they had not considered that an audit might influence the bank, but imagined that it is favorable for a company to have an auditor to gain access to larger credit. NA2, NA3, NA4, NA6 and NA7 also never previously considered audit as a determining factor for banks, creditors or suppliers but were all of the opinion that it is beneficial to have an auditor if the company is highly leveraged. NA4 and NA7 believed banks want assurance from someone external or distanced from the company when reviewing the current financial situation of firms. NA6 clarified that they have never thought about this factor because their auditor did not talk about any kinds of issues with them, and NA6 simply did not know that audited financial statements can have a signaling effect to banks.
WA1 stated that all creditors or outside parties, especially banks, care but they have never considered it, because they have no debts.

Regardless of group, no company has experienced any changes in interest rates or conditions with their banks or creditors after becoming exempt from audit.

4.3 Credibility with Business Partners

Most of our sample companies had never considered if prospective business partners have audited financial statements.

In the AU group, AU1 and AU2 did not check financials or audit status of prospective business partners in a new business relationship. AU1 really consider what business partners and external parties think about their business. The respondent pointed out that they work with big, well-known organizations and it is therefore important for AU1 to have assurance that they work well and according to relevant standards. AU1 perceived no need to check their business partners as they are required by law to have audited financial statements due to size. Moreover, AU1 has never felt that there was doubt about the solvency or liquidity of a business partner or customer. AU2 currently do not check business partners and do not plan to do so, but could imagine that an auditor increases security when doing business. In contrast, AU3 finds it really important to check if another company is solvent. Their auditor performs this control as the auditor knows what to look for and what is important to consider before starting a business relationship and AU3 do not.

In the NA group, NA1 and NA3 confirmed that they usually verify their business partners’ financials but clarified that it is not a check of audited financial statements but rather of key ratios. NA1 had concerns that possible partners or customers cannot afford to pay them, and therefore do credit checks. As NA1 do not engage in large business ventures, even if the partner went bankrupt it would not damage them greatly. This statement was echoed by NA6. Contrary to NA1, NA6 considered it unimportant to check on prospective partners as they mainly work with well-known, solvent companies. NA4 and NA7 found this scrutiny of prospective business partners significant only in close partnerships, e.g. buying a store together. In daily business and purchase of regular services, they did not consider the financial statements or auditor status of the business partner. NA2 did not find it important to look at auditor status as they mainly do business with companies they have good experiences with from their previous career. NA5 also did not perceive audited financial statement important in day-to-day business. If they were to sell their company or buy another company, they might think that audited financial statement could be advantageous. However, they stated that this is not a regular situation, and not a reason for an annual audit.

WA1 also did most business with people they know and saw no need to check for audited financial statements. WA1 also believe that their business is not big enough to make the effort to verify their business partners’ financial statements.
4.4 Cost-Benefit Considerations

4.4.1 Costs
Most of our sample could not say how much they pay for audit or accounting services and many of them saw no possible benefits of an audit apart from the external control function.

In the AU group only AU3 brought up the amount they pay their audit firm and added that they think it is too much. AU1 could not tell us the amount of money they pay their audit firm, but judged the proportion of their expenses for accounting and audit to be 50/50. Their financial statements show the amount as 75/25. Furthermore, AU1 stated that the audit and accounting costs are their biggest expenditures apart from wages and that they are not happy to pay this amount. AU2 had no idea how much they pay for audit or accounting.

NA1, NA5 and NA6 could answer how much they pay their auditor. NA1 immediately named the exact amount they had paid for audit, but perceived it was too much compared to their low turnover. NA5 came up with a circa amount for the accounting and auditing services and judged that forty percent was for audit services. They had not checked prices of other audit firms. NA6 did not mention the total amount they paid for audit or accounting services but named the auditor’s hourly wage. NA6 was the only company that have compared prices of two audit firms when their previous audit firm was sold to a Big Four firm and they were considering if they should follow the firm or not. They did not act on the information they gained. In contrast, NA3, NA4 and NA7 were not aware of what they paid for their auditors but were happy and relieved to not have the costs any longer. NA2 did not answer if they knew the specific amount, but believed that it is not much cheaper without an auditor as they still need someone to check their books and advice them on tax issues.

It was not possible to verify the costs for most of our sample, because this was not specified in their financial statements. We can therefore not determine if the mentioned costs are correct.

4.4.2 Benefits
All our respondents perceived the audit as an external control mechanism that monitors if their bookkeeping and financial statements are correct and comply with rules and legislation.

The AU group thought audit is beneficial for them. AU1 appreciated the consulting function their auditor fulfills. AU1 valued the specific skills of their auditor as they do not have any education in accounting. This competency is particularly important for the respondent as rules and legislation in accounting continually changes. The most important issue for AU1 is to provide “clean papers” to interested parties. AU1 has experienced that there are a lot of “grey areas” where they do not know what to do and the auditor helps them make the right decisions. Moreover, AU1 emphasized that they have more time to spend on their business.

AU2 also perceived advantages of audit. They believe the audit gives them security and control in their business. Their auditor ensures that everything is correct and works well in AU2. Furthermore, they think it is pleasant to know they have someone to rely on.
and trust. This trust has developed over time as AU2 worked with their audit firm. That their auditor knows the business and AU2 can always ask for advice in accounting issues where they lack knowledge makes it worthwhile for them to pay the costs for these services. AU2 had the feeling that they receive really good service from as their auditor has a high position in the audit firm. That is why this respondent does not mind paying more for the audit and accounting services than they might in other firms.

AU3 also found the benefit for them was to have someone who takes care of issues they are uncertain on. This provides AU3 with a feeling of safety as they are afraid to make mistakes if they had to handle the accounting. AU3 appreciated the auditor’s availability when they have questions about important issues that the accountant cannot answer. Furthermore, AU3 perceived that having an auditor provides them with an advantage regarding controls from banks and tax office, which is important as they have been through a tax audit once (and it is not an experience they wish to repeat). In addition, AU3 pointed out that they kept the auditor because they wanted to “continue as usual”, which has worked well previously.

All but NA5 in the NA group see no important benefits in having an auditor or any advantage in having an auditor in addition to their accountant. The respondents were not of the opinion that the auditor does different work than the accountant. “[T]he auditor just goes through the things which are already correct” which is an “unnecessary expense” (NA1). The benefit NA1 could imagine was that there might be less control from the state and tax office but still thought that an auditor costs too much. NA2 also named the control function as a possible advantage, but felt that the accountant is assurance enough. They were happy to avoid the administrative burden, but believe it is not much cheaper now. NA4 and NA7’s accountants had saved them a lot of time and stress, but they had not experienced this with their auditor.

NA3 saw two benefits of audit; a control that the financial statements are correct and advisory services. Nevertheless, NA3 did not perceive these benefits as being crucial and thought the benefits did not justify the costs of an auditor. They think they can handle a lot of the accounting work themselves as their business is small and uncomplicated. NA3 believed that they had developed a sense of what their numbers should be. When they find an unusual amount of for instance value added taxes, they contact their accountant for advice. NA6 shared this view and saw any benefits of an auditor; they stated that they do not know what function an audit has or what an auditor does. NA6 wished that the auditor would have informed them about possible advantages or what an auditor actually does. NA6 perceived the auditor’s work as “worthless” and were happy when they heard that they could avoid paying for an auditor as they saw the audit only as an additional expense every year.

In contrast, NA5 perceived differences between the work of an auditor and an accountant. NA5 would consider having an auditor again if their company grew and had a higher turnover, as the cost for an auditor would not be as relevant as it is now. NA5 added that they would engage an auditor when they feel that there are more administrative burdens to face by not having an auditor, for instance more tax audits. At the moment, NA5 managed their accounting mostly on their own by using an e-bookkeeping system. If they have questions, they can get help from the accountant. Like NA6, NA5 complained that they did not get as much advice as they would have wished from their auditor or accountant.
WA1 thought that the benefits of audit do not outweigh the costs in a small company.

### 4.4 Education Level

The level of education in our sample companies range from owners (respondents) with a university degree to owners (respondents) with Swedish 2-year high school. No respondents have an educational background in business.

AU1 was educated as a welder and also graduated from folk high school, majoring in behavioral science and do not have the necessary skills to deal with financial issues such as accounting. AU2 is a textile teacher that has no interest in accounting issues and it is therefore necessary to have somebody to help them with this kind of work. AU2 also appreciated the advice they receive on bookkeeping. AU3 trained as a plumber and emphasized that they are not interested in any business (administrative) work at all. They are afraid to do something wrong in accounting and therefore perceived it as an advantage to get advice and help with the accounting in their company, but do not really know the work and function of an auditor.

In the NA group, NA1, NA3, NA4 and NA7 have owners whose highest level of educations is high school, none of them in business. NA1’s only participation in accounting was monthly meetings with their accountant. In contrast, NA3 believed they were themselves able to handle most of the accounting, as they are a small company with simple bookkeeping. If they were uncertain, they could always ask the accountant. NA4 first tried to handle the accounting alone but their audit firm had to redo it at year end. This is why NA4 decided to engage an accountant to help them, their background is technical and the professional help saves them a lot of time and stress. However, NA4 are still interested in learning bookkeeping and learns from their accountant. NA6 has a vocational technical education and has worked with business and administration in another company previous to purchasing NA6. They do their daily accounting but engage an accountant for financial statements and tax issues. Both owners in NA7 have high school educations, and even though they are interested in learning more about accounting, they leave everything but daily bookkeeping to their accountant.

The final NA respondents (NA2 and NA5) were educated as engineers (4-year university degree). NA2 has extensive experience in the business world and has held high positions in other companies and sits on supervisory boards. Nevertheless, NA2 perceived their own skills in accounting as insufficient to work with difficult and specific accounting issues. They were not afraid to ask the accountant for advice and think that it is important to have someone that helps them with these issues. NA5 use an e-bookkeeping system and are interested in learning accounting. They believe they can handle the bookkeeping mostly alone but also value having an accountant available for questions and advice, especially at yearend financial statement.

The educational background of WA1 is a six years post high school education as producer and production manager with no specific accounting background. They have taught budgeting to film students and have a grasp of the basics. They do all accounting alone, although for the financial statement they will get help from their step-father, who also provides them with advice when they have questions during the year.
4.5 Non-Audit Services

The AU group all has an auditor and accountant from the same company. AU1 appreciated the consulting function their auditor and accountant provide, especially being updated on rule changes regarding bookkeeping. AU2 also valued having both auditor and accountant; to receive advice and add security to the company. AU2 also perceived that the auditor and accountant really know the company and therefore gives better advice. This was also a reason for AU2 to not change audit firms as these advantages would disappear and they would have to get to know new people that in turn must learn about AU2. The respondent mostly has contact with the accountant but always consults the auditor in important issues. Furthermore, AU2 perceived it as advantageous that auditor and accountant were from the same company as they can communicate on relevant issues. AU3’s accountant was always available for questions and they only need to contact the auditor when the accountant cannot answer. AU3 mainly has contact with the audit firm via telephone and mail and the accountant does all bookkeeping and the daily accounting.

In the NA group, NA2, NA5 and NA6 purchased audit and accounting services from the same firm. They all kept their accountant as they perceived it as necessary to have someone who checks their books and provides advice on bookkeeping. None of these three companies answered if they have experienced advantages from engaging an accountant and auditor from the same company. NA6 stated that they appreciate that their accountant keeps them updated about new rules and legislations and provides specific advice for their company. Furthermore, NA6 believes that an accountant or auditor is more valuable when they have special knowledge about your business and industry as this strengthens the consulting function.

In contrast, NA1 and NA3 did not purchase audit and accounting service from one firm. They explained that it was their accounting firm that hired the auditors. NA1 said their accounting firm took care of everything about the audit service. NA4 and NA7 have one accountant who comes to them and helps them with the monthly bookkeeping, whereas the accountant who does the year end accounting is from the same company as their former auditor.

Relationship Factors

We use three different types of relationship/connection in the text. These are business relationship: a basic contractual relation, personal relationship: based on an emotional, but not deep/close, attachment or feelings of someone close (i.e. friend of my friend) and private relationship: relationship, e.g. friendship, unrelated to business.

4.6 Client Acquisition and Retention

The AU group had previous knowledge of and connection to the auditor that they chose to work with. Two of them, AU2 and AU3 had a private connection from their social lives to the auditor, whereas AU1 chose their auditor partly due to interaction in a semi-professional setting and partly through a personal recommendation. All of the AU respondents have recommended or talked favorably about their auditor to others. AU1 confirmed that they believe word of mouth to be the most important factor in acquiring new customers.
Only NA5 chose their audit/accounting firm through anything but a personal recommendation. The owners of NA5 have only lived in Skellefteå for 5-6 years and moved there for job opportunities. They had no personal or private connection to Skellefteå previous to their relocation. All other respondents are from Skellefteå and had personal or private reasons to choose the firms that they did. In all cases, the respondent or someone close to the respondent personally knew someone from the firm and chose to hire that individual rather than the firm as such. Five out of the seven respondents (NA2 and NA5 have not had to change accountants) have stayed with the firm when the person they initially chose for some reason leaves. NA4 and NA7 would change audit firms if they had a friend that worked at another audit firm who asked them to switch.

NA6 is the only respondent who has changed firms, when a Big Four audit firm bought the audit firm NA6 was using, they decided to go to the Big Four firm even though neither the auditor nor the accountant would be working at the Big Four firm. NA6 explained this by saying “[The auditor] thought I should go to [Big Four firm], and as he had been very loyal to me…I wanted to be loyal to him too.” NA2, who was the other dissenter, would go with their accountant whom the owner has long-standing professional and private relationships with.

Almost all of the NA respondents have recommended or talked in a positive manner about their audit firm to others. NA2, NA3, NA4 and NA7 recommended their accountant personally, whereas the others have spoken about the firm as a whole. NA5 talked about their audit firm, but do not want to recommend them to others as they have nothing to compare their services with.

WA1 do not use any accounting or audit services but has family with similar companies and a step-father who is an auditor that he would use as a consultant if needed. They have “of course” recommended the step-fathers firm to others.

### 4.7 Personal and Private Connections

As we mentioned above, the AU respondents all chose auditors that they had personal or private connections with. All said that they talk to their auditor in “grey areas” (AU1), “big” (AU2) and “sensitive” (AU3) questions. The respondents in this group have at least some social (non-business related) interaction with their auditor, although it is only AU3 who has any regular and deeper social contact (i.e. hobbies, birthday celebrations) with the auditor. AU1 expressed an unwillingness to interact to closely with his financial advisors, as it is easy to start “fudging the rules” in that kind of relationship.

A varying degree of interaction occurred between the NA group and their auditors and accountants. NA1, NA5, NA6 and NA7 had little or no interaction with the auditor aside from receiving the auditor’s signature on the audit report. NA5’s main interaction with the auditor was when the company was started as “[the auditor] was there and shook our hands”. NA2 had a long professional relationship with his former auditor, but it is not someone they socialize with, they do however have a private relationship with their accountant with whom they spend time with outside of work. NA4 has sold their professional services to the audit firm, and NA3 continuously sold their services to individuals working at their firm, including their auditor. NA3 was the NA-company with the most auditor interaction, most of which occurred after one of the owners
divorced the original accountant, with who the owner also has children. The respondent added further that they have relatives who are in the accounting business, but felt that they did not want to expose their business to everybody.

Respondents from both groups have monthly meetings with their accountant, where the topic mainly is the accounting. The AU group and six of the NA group (not NA5) also stated that their auditor (AU) or accountant (NA) is someone they could imagine socializing with.

4.8 Affective Commitment

4.8.1 Service quality and Satisfaction
The AU group expressed satisfaction on the service quality by the audit firm. The respondents felt that they benefit from the advice from their auditor and that the auditor has been available to help them in the way that was required. AU2 was especially satisfied by the fact that their auditor has a high position in the audit firm, but still has time for their small company and gives them a lot of attention. AU3 is the only respondent that talked about dissatisfaction in the relationship, either on a business or personal level, as a reason to change firms.

The NA companies spoke less about quality of service from their accountants. NA6 was happy with receiving advice about e.g. handling profits, but would like more advisory service. There have been mistakes made by the accountants that the respondent has found but which have been corrected as soon as attention was brought to them. NA6’s previous accountant had offered no advice and had made at least one bigger mistake, but the decision not to keep that accountant was based on feelings of loyalty towards the former auditor. NA5 complained that they received too little advisory services, and noted that they could not always get a hold of their accountant when they had questions.

In contrast, NA4 and NA7 expressed positive sentiments about their accountants teaching them more about bookkeeping. NA3, NA4, NA5 and NA6 contacted their accountant outside of the monthly meetings, a service which NA5 noted did not cost extra. NA1 mentioned the flexibility of his accountant as a positive trait. No NA-company had experienced many mistakes by their accountants, and no mistake had been brought to their attention by the audit. No NA-respondent mentioned an instance where their accountant had not been able to answer their questions or help with problems that they had, although NA3 received additional help from their auditor when they changed accountants and were uncertain about the new and relatively inexperienced accountant’s abilities.

4.8.2 Trust
AU2 spoke a lot about feeling safe with the auditor and the audit firm. For all important issues, they contact the auditor for advice. AU2 “trust [the auditor] 100%” and that kind of trust is worth a little more money. AU3 speculated that because there have not been any problems with the financial statements, they have confidence in the auditor and this is why they keep using the service. Neither AU1 nor AU3 thought that their auditor would take advantage of them and their ignorance in financial matters, but that there might be some opportunistic or selfish elements in how the auditor or audit firm acts.

NA1, NA4, NA5, NA6 and NA7 were directly advised by their accountant to dismiss their auditor, that the auditor was not necessary for the companies. NA5 brought this up
as a trust factor, as they “would not have believed [the accountant] if she had said anything else.” NA5 trust the accountant quite a lot. Except for NA1, all NA-companies can be quoted with similar statements ranging from NA5’s “quite a lot” to “great confidence” (NA2). NA3, NA4, NA5 and NA7 believed that the audit firm might very well have opportunistic elements in how they work, but as the outcome is positive it does not matter. NA7 mentioned that good business practice is to do what is best for the customers, and therefore believed that the audit firm would act in that manner. NA1 did not believe any such selfish behavior existed in the firm.

4.8.3 Interdependence

The AU group all worked together with their auditor, as they have regular contact and AU3’s auditor handles contact with the bank and other paperwork that the respondent does not want or know how to do. AU3 and the auditor do a little work “off the books”, trading professional services with each other. AU2 and AU3 had little knowledge transfers as neither respondent expressed a desire to learn more about their finances or accounting, and AU3 had a lack of commitment to, and a fear of, paperwork. In contrast, AU1, that has not had a professional accountant until 2012, tries to learn more and have a better sense of regulations and company finances. AU1 and AU2 opined that their audit firms adapt the accounting and audit processes to suit their companies, especially AU1 whose auditor has been long with the company and has great knowledge about the business. AU3 was more hesitant on the issue of adaptation.

In the same way as the AU group, the NA group also has regular contact with their accountants and are in that way co-operating. As mentioned previously there is also a professional exchange between NA3 and NA4 and their audit firms. Those companies that did more of their own bookkeeping were also the ones who expressed a desire to learn more about accounting, although NA2 had enough experience to not need this kind of service and did not talk about or indicate that there were any such knowledge transfers. NA4, NA5, NA6 and NA7 expressed an aspiration to learn more about their finances and their accountants at least in part fulfill this function. In addition, NA5 and NA6 spoke of a desire to receive more such instruction, and this was a possible reason to change audit firms or accountant.

The four NA respondents that believed their accountants adapt were divided between those who hesitantly said that the accountant adapts and those who were certain of it. NA3 and NA5 stated that the accountant might adapt slightly, NA3 added that their auditor had not adapted as they compared how the auditor had worked in another company where NA3 know the owners. NA6’s accountant knows how the company works and what the respondent values, and perceives this to be why the accountant adapts to the company. NA4 and NA7 believed there is adaptation due to the willingness from the accountant to teach accounting practices and that most companies do not make the same request to the accountant. NA2 perceived that their accountant works with similar companies in a comparable way as with NA2.

4.9 Calculative Commitment

AU1 and AU2 stated that their auditors are quite familiar with their companies and how they work. Both thought it would be less comfortable to change audit firms as the new auditor had to learn the things about the business that their current auditor already
knows. AU3 showed very little interest or knowledge about their financials and accounting.

NA5 is the only NA respondent that perceived difficulties in changing firms, due to the size of Skellefteå and the length of the relationship. The smaller size of the town has given the respondent an unwillingness to change firms as they do not want to offend anyone and they perceive that the risk is bigger in a smaller town than in for instance Stockholm.

In both the AU and NA groups, there is a worked-in relationship between the respondent and their audit firm. NA5 and NA6 spoke about other audit firms, where NA6 had taken the initiative to look into the possibilities of other firms and NA5 received unsolicited offers or information. Neither NA5 nor NA6 changed firms based on the information they found.

Further Relevant Findings
The qualitative nature of our semi-structured interview provided the opportunity to discover additional factors that matter in the decision to retain or dismiss the auditor in a micro-entity which we had not found in previous research. In this section we present those factors.

4.10 Other Determinants of Voluntary Audit
First thoughts, when learning of the audit exemption in the AU companies, were quite varied. AU1 interpreted the new legislation as a reduction in administration and less strict accounting practices, but soon realized that as the bureaucracy was unchanged they wanted to keep the auditor. AU2 and AU3 thought that they still needed someone to help them in accounting matters, but had no other reflections. To receive advice, AU1 had a conversation with their auditor based on the reasons to continue with the audit as before. They talked quite a bit about it, but AU1 did not provide in the interview if the auditor had specifically advised them as to the final decision. AU2 also talked with the auditor, but did not reveal if the auditor had given specific advice. AU3 decided to just “keep going as usual” without advice from anyone.

NA1, NA4, NA5, NA6 and NA7 thought that it would be cheaper to dismiss the auditor and that was positive, NA2 also added that it was a positive development as a matter of principle since they do not like to be forced to do things in their business. Furthermore, all NA companies except NA3 talked to their accountant about the options concerning voluntary audit. In all cases the accountant said it was not necessary to have an auditor in the company.

NA3 had a confused initial reaction as they had not understood what the exemption meant. They asked their auditor who advised them to keep the audit services which they also did for the first year, but are now dismissing the auditor for the next fiscal year. NA3 did not have an explanation as to why they decided to dismiss their auditor this year.

WA1 had a meeting with their step-father who advised them against hiring an auditor.
4.11 Perception of the Function of Audit

The AU group thought audit was an external control function, to make sure that the accountant does not make mistakes (AU3), to see that everything is done properly in the company (AU2) and a police function to stop irregularities (AU1). AU1 stated the control function as the most important one, adding that advisory is also a function of audit.

In the NA group, NA2, NA3, NA4, NA6 and NA7 said the main function was that the auditor is a control element to see if the accounting is correct, done according to accounting standards (NA2) and that the control is mainly a function for the government and tax office (NA1, NA2, NA4, NA5, NA6 and NA7). The information and knowledge gap between a board of directors and the CFO was brought up by NA5, who also were of the opinion that the auditor was an independent review of the company. No other respondent mentioned auditor independence.

WA1 reflected that the auditor’s function was to “clear up the mess you would do if you didn’t have accounting help!”
Chapter 5: Analysis of Empirical Findings

This chapter will provide an analysis of the empirical observations in chapter 4. The analysis refers back to previous literature about business and relationship factors covered in chapter 3 and further relevant findings in regard to our research questions.

Business Factors

5.1 Firm Size and Agency Factors

According to previous literature, internal control is an important factor in deciding to have an auditor due to information asymmetry within the firm caused by separation of ownership and management as well as delegation of tasks (Carey et al., 2000, p.39). The likelihood of these factors increase as firm size grows, which is therefore said to be a determining factor for voluntary audit decisions (Allee & Yohn, 2009, p.8; Hay & Davis, 2004, p.40).

Of our eleven respondents, only NA5 named internal control as a function of audit without being prompted by an explicit question. After being asked specifically about internal control, most of our respondents were hesitant in their replies. This indicates that internal control is a function of audit the respondents are unaware of, and can therefore not be a determining factor for voluntary audit in these micro-entities. When encouraged by a specific question on internal control, the respondents still found no relevance to companies their size as there was no separation between ownership and management. Thereby we confirm the findings of Tabone and Baldacchino (2003), that “firsthand knowledge” of the business decreases the need for internal control mechanisms. No company had board members that were not owners or close family members of owners. There was also little delegation of tasks, only AU1 and NA6 had non-owner employees that were not closely related to the respondents. All but NA2 did however believe that internal control would be a function of audit for a larger company.

Collis et al. (2004) found that the determining factor representing firm size was turnover, and it is interesting to note that the three companies in the AU group are also the companies with the largest turnover. Although this might be a deciding factor for voluntary audit, it is not something brought up by the AU respondents. Both NA1 and NA5 talked about their low turnover as one of many reason not to have an auditor. This is however not sufficient grounds to claim that our respondents considered turnover when deciding on voluntary audit, and it is not within the scope of our thesis to look beyond their conscious choice in the matter.

Interestingly, AU3, NA5 and NA6 brought up a relatively new phenomenon of agency conflict. When asked about the general function of the audit, they answered that they perceived it as an additional check on the accountant. This is consistent with the findings of Niemi et al. (2012), where the authors provide evidence that this kind of information asymmetry occurs mainly in small firms as there exists a greater likelihood of outsourcing the accounting function. As none of our sample companies have their own accounting department due to the companies’ small size, this might be a relevant factor for conducting voluntary audits in micro-entities. Even though our other respondents did not mention this agency problem specifically, NA2, NA3, NA4, NA7
and WA1 did say that the general function of audit is to ensure the accounting is correct, which could be interpreted in the same way as the statements by AU3, NA5 and NA6.

The respondents can be said to confirm previous studies of the positive correlation between firm size respective delegation of tasks and the demand for audit, as their perception was that a larger company would in fact benefit from having an auditor to monitor their internal control. They could not confirm any such idea on firms of the size that are exempt from audit by Swedish legislation, which implies that these factors are not a determinant for engaging an auditor in Swedish micro-entities.

5.2 Amount of Debt, Credibility and Insurance Effects to Banks
Contrary to the previous findings of Blackwell et al. (1998), Kim et al. (2011) and Lennox and Puttman (2011) who found that firms experience advantages in interest rates when they could provide audited financial statement, no respondent in any group has experienced changes in interest rates or conditions with banks or creditors when they retained or dismissed their auditor after they became exempt. However, only NA1 has any long-term debts and only a small amount. This confirms the findings of Seow (2001), which provide evidence that only a high amount of debt was positively associated with the choice of audit. The only respondent whose bank expressed interest in their financial statements was AU3, which they put this in context with the business going through hard times. AU3 did not mention this as a reason to have kept the auditor, but was happy to have the auditor as an intermediary in such cases.

All companies but NA6 believed banks would take an interest in their auditor status if they had large debts, thereby we can say that their perception is that amount of debt is a contributing factor in the choice of voluntary audit. However, the respondents did not place as much emphasis on this factor as they did on others, which might be due to the fact that they (except NA1) have no debt and therefore no need to increase credibility or provide insurance to banks. On the other hand, their replies are consistent with studies by Collis (2012) and Niskanen et al. (2009), who could not find a correlation between the choice of voluntary audit and external demand thereof in micro-entities respective small family-owned firms.

5.3 Credibility with Business Partners
Audited financial statements can have a signaling and assurance effect to business partners and might therefore an important driver for companies for engaging an auditor (Kim et al., 2011, p.588; Lennox & Puttman, 2011, p.1658).

Only AU3, NA1 and NA3 told us they investigate prospective business partners. These checks are mainly on financial numbers, e.g. liquidity, and not on auditor status. AU3 noted that it is their auditor who does the controls; auditor status might be something the auditor finds to be important, however cannot be confirmed by AU3. NA1 stated that they do not do big enough business for their company to go bankrupt if the unaudited financial statement of another company was misleading. For everyday business, all other companies do not check their business partners. This is for varying reasons, but mainly because they work with well-known actors in business transactions that are not big or intimate enough to warrant a check.

Again, we find that previous studies do not match our respondents’ answers due to company size. Our micro-entities do not perceive their business as big enough to justify
a detailed and time consuming check. In addition, their answers imply that micro-entities may have closer relationships as they not necessarily act worldwide but rather have a geographical proximity to their business partners. This increases the trust in their business partners, so that audited financial statements in regard to credibility do not matter to our sample companies.

5.4 Cost-Benefit Considerations

5.4.1 Costs
Audit costs are believed to be one of the main driver for the decision of an audit (Seow, 2001, p.71), only AU3, NA1, NA5 and NA6 could name an amount they pay for their audit, although every company but AU2 complained that the audit cost was too high. AU1 told us the proportion they pay for audit and accounting but was quite far off from the actual proportion. As AU1 was very vocal on how reluctant they were to paying audit and accounting fees, it is telling that they along with most of our respondents had no idea how high the fees are or what they are actually paying for. Only NA6 have ever actively checked the prices of other audit firms, and then only in a limited capacity, which implies that the respondents are not bothered enough by the cost to investigate if there is a cheaper option. Alternatively, the respondents do not believe that there is a cheaper option and it is useless to check. However, this is our own, unfounded, assumption. We believe that this behavior is not uncommon in the exempted Swedish micro-entities, as many do have no business background, nor does one transform into a business person simply by owning a business.

From our NA group, all but NA2 felt that the costs of audit were too high, implying that this was a strong reason for them to dismiss their auditors. This matches our expectation from the literature review; the costs are a fundamental factor for particularly micro-entities as audit costs do not increase proportionately with the size of the firm (Chow, 1982, p.276; Keasey & Short, 1990, p.307, Collis, 2012, p.23). Due to their lower turnover and general expenditures, the audit costs in our micro-entities are heavier than in larger firms and are not perceived as insignificant compared to cost burdens of regulation bureaucracy or other service as suggested in previous literature (Marriot et al., 2006, p.22). Nonetheless, AU1 and AU3 in the audit group did not dismiss their auditor though the costs were perceived as high. However, as mentioned before, the AU group were also the companies with the highest turnover, which was found to have a positive correlation with voluntary audit (Collis et al., 2004, pp.90-95).

5.4.2 Benefits
Matching the previous research from SMEs (Collis, 2008, p.56), all our respondents viewed audits as an external control mechanism. This was, in contrast to the question of internal control, a spontaneous reply from the respondents and complies with our expectations that micro-entities are concerned with external rather than internal control mechanisms.

The AU group all found the auditor to be beneficial to their company, as an extra layer of protection against mistakes and the consequences thereof, e.g. to be audited by the tax office. Furthermore, they all heavily relied on the consulting and advisory services of their auditor, and did not make much use of such functions with their accountant. This is consistent with the findings of Tabone and Baldacchino (2003) and Collis (2012)
which indicate that the auditor in micro-entities serves as a check on inherent and control risk to decrease material misstatements and is perceived as a business consultant due to their expertise and experience. Even though not explicitly mentioned by our AU respondents, their reliance on the knowledge of and protection by their auditors can be interpreted that the auditor acts as an additional assurance for our micro-entities.

In contrast, the NA group (aside from NA3) has only used their accountant for consulting and advisory services and therefore has seen no additional benefits by having an auditor. We found that the respondents see very little difference between the work that an accountant and an auditor do because they have no knowledge of the different functions of these professions. Therefore it is obvious that the NA respondents would not see any major benefits by having an auditor. The threat of external controls, such as tax audits, was not sufficient to warrant retaining the auditor when the accountant provided comparable assurance. This indicates that the cost for auditing services outweigh possible benefits in Swedish micro-entities as eight out of eleven of our sample companies decided not to have an auditor when exempt.

Moreover, in companies of this size, the accounting is not very complicated and the respondents have a good overview of the finances, thus reducing the need for additional controls from the auditor. NA3 and NA5 explicitly stated that due to their company sizes, the accounting is less complex and is something they have a good understanding of. However, NA4 and NA7 as well as AU1 said that there is a definite time-saving benefit by using professional services. It is quite interesting to note that these companies have the same perception of what benefits they gain, although they gain them by hiring different types of professionals, accountants or auditors. This implies that possible benefits like time-saving and assurance brought up by previous literature (Seow, 2001, p.71; Collis et al, 2004, p.97) are relevant for Swedish micro-entities, even though it is not explicit associated with an audit function, but rather with general accounting services. It is easy to assume that the same applies for most or all of the micro-entities exempt from audit in Sweden. This is consistent with previous studies that found a positive correlation between complex organization structures as well as the number of business sites and the need for audit (Allee & Yohn, 2009, p.8). Hence, for the majority of our micro-entities the work of an accountant is perceived as sufficient to provide the benefit of required assurance.

5.5 Education Level

There are two conflicting findings from previous studies, that lower education increases the need to hire an auditor due to a lack of accounting expertise and that higher education increases the perceived benefits of having an auditor and therefore the likelihood to remain an audit (Allee & Yohn, 2009, p.17; Tabone & Baldacchino, 2003, p.396). As our sample contains everything from 2-year high school to higher university degrees, mixed in all groups, we cannot claim to be able to draw any conclusions. However, the respondents that were most knowledgeable about accounting and the function of audit (NA2 and NA5) were also the ones with the highest levels of education. We believe that the knowledge of higher education (i.e. finding, interpreting and using information) combined with the less complex accounting of a micro-entity may be contributing reasons to their non-auditor status.

All other respondents are without relevant educational and business backgrounds and would therefore, according to previous studies, be more likely to hire an auditor. This
was also the result we were expecting, but in our sample, education level was not a

determining factor for retaining or dismissing an auditor. As stated previously, the lack

of business backgrounds of all our respondents, made them appreciate the professional

advice and assurance they received from their audit firm, not necessarily associated with

the auditor. For the NA group this association was rather with the accountant. Due to

the range of education levels included in our sample, any connection between the choice

of voluntary audit and education is incidental.

5.6 Non-Audit Services

Previous literature suggests that companies that purchase non-audit services from an

audit firm are more likely to engage an auditor from the same firm due to cost-benefit

advantages (Knechel et al., 2012, p.64). All respondents in the AU group have audit and

non-audit services from the same company, and five out of seven NA companies also

purchased audit and non-audit services from the same company, which might indicate

that there is an advantage by combining the services in the same audit firm. However,

none of the respondents stated that they believed they have benefited from economies of

scale by using the same firm for audit and non-audit services. NA1 and NA3, that had

accounting and audit services from different firms, both use an accounting firm that

does not employ any auditors, and it was the firm that hired the auditors for the

companies. We believe that combining the services or, as in the case of NA1 and NA3

letting the accounting firms decide which auditor to use, were based more on

convenience than by any other consideration. On the other hand, one can argue that this

convenience can be interpreted as economics of scale.

Relationship Factors

As the NA group has decided to not have auditors, this part of the analysis is focused on

their relationship to their accountants as well as auditors. The analysis of the AU groups

is centered on the relationships with their auditors.

5.7 Client Acquisition and Retention

According to previous studies, word-of-mouth is the most effective marketing tool for

customer acquisition (Villanueva et al., 1999, p.58). Our study shows that aside from

private relationships, word-of-mouth was the most common reason for our respondents

to choose their audit firms. Word-of-mouth is a byproduct of having a good relationship

with the client (Kuenzel & Krokoliwksa, 2008, p.338) and all of our respondents

aside from NA5 have recommended or talked favorably about their accountants or

auditors. The AU group, WA group as well as NA2, NA3, NA4 and NA7 have

recommended the individual they work with rather than the firm. This implies that their

satisfaction is tied to the person they have the better relationship with, as the AU group

interact more with their accountant than their auditor, yet it is the auditor they have

personally recommended.

Only NA5 will not recommend their audit firm; they state that it is because they have

nothing to compare the service with. This is true for other respondents as well; nonetheless they recommend their firm or auditor/accountant. NA5 is also the company

with the least connection and sentiment to their accountant, which might be the reason

for their reluctance to recommend them in the way our other sample companies do.
When their original accountants for different reasons could no longer be the companies’ accountants, the NA group (except for NA2 and NA5 who have not experienced this) stayed with their audit firms, which is contrary to our assumption that it is the personal relationship that satisfies the respondents. However, relationships still might be a component in the respondents’ decision, even if this tells us it is probably not the determining factor in choosing a new accountant or auditor when forced by circumstances to do so. The choice seems to be passive rather than active when there is not the option of choosing a person you have a prior connection to, but a good relationship might still be a contributing factor to firm loyalty (de Ruyter & Wetzels, 1999, p.63). NA6 was advised by their auditor to go to the Big Four firm, rather than go with their accountant, when they could no longer stay with their previous audit firm. They chose to go to the Big Four firm out of loyalty to the former auditor, which implies that it is the primary (most important) relationship that accounts for client retention. It is quite possible that the other NA respondents stayed with their audit firm on similar reasoning, as it was not possible to follow the person they originally hired and the companies could thereby only be loyal to the firm. We reason that this loyalty was built by the relationship between the two persons (Čater & Čater, 2010, p.1325), rather than the firm and the client, and was then in part transferred to the firm when the business relationship with the accountant had to end.

5.8 Personal Connection

The AU group as well as NA2, NA3 and NA6 chose their audit firms due to a private or personal connection. These are already established social bonds that adds to affective commitment (Čater & Zabkar 2009, p.785) which in turn leads to loyalty (Čater & Čater, 2009; 2010; Čater & Zabkar, 2009). We found the highest degree of private relationships in AU2, AU3, NA2 (and WA1). We believe that as these companies already had previous personal relationships to their auditors (for NA2: accountant), it would have been easier to build good professional relationships based on the previous connection.

The AU group all have a previous immediate personal or private relationships with their auditors, whereas the NA group does not, therefore we theorize that the AU group has had no need to connect with or build a relationship with their accountant in the way the NA group (aside from NA5) have done. There has to be a desire to develop the relationship for the relationship to grow (Sharma et al., 2006, pp.65-69) and produce the affective commitment effects. Even though all respondents aside from AU1 say that the accountant is the one they have the most regular contact with, only the NA group cultivated that relationship. AU1 stated that their contact with the audit firm always was with the auditor, yet the financial statement shows that only 25 per cent of the fees to the audit firm were services performed by the auditor. Thereby it is quite possible that there has been much more contact with the accountant than AU1 recollects, but they still have their primary relationship, or “highest emotional intensity” (Stanko et al., 2007, p.1101) relationship, with the auditor.

Although all AU respondents told us they go to their auditor (with whom they have a personal/private relationship) rather than their accountant (whom they have little relationship with) with more difficult and intimate questions, the NA respondents’ accountants performed the same function for them. Again, it seems that it is the primary relationship that dictates who can fulfill the needs of the respondents.
It is interesting to note that both NA3 and AU1 have objections to having too close
a relationship with the person doing their accounts. AU1 said those instances make it too
easy to break rules, whereas NA3 was uncomfortable with letting relatives into their
finances. The study by Bäckström et al. (2009) showed that there were large differences
between a close personal relationship and a good professional relationship which, in
combination with the statements from AU1 and NA3 makes us speculate that the type
of personal relationship matters when creating a professional one. AU3 was the only
respondent that clearly stated that dissatisfaction in the (business or personal)
relationship as a reason to change firms, and AU3 is also the only respondent with an
ongoing close private relationship with their auditor where the relationships base was of
a private nature. This might mean that close private relationships are more volatile to
base a professional relationship on than a personal connection.

5.9 Affective Commitment

5.9.1 Service Quality and Satisfaction

No respondent expressed dissatisfaction with their auditor or accountant, which is
logical when one considers that they do not look for other audit firms or have thought
about changing firms. It seems that the one of the main reasons for staying with the
audit firm is convenience, as NA1 and NA3 talks about geographical convenience, and
AU2, AU3 and NA5 about the convenience in a long-standing working relationship,
and it would take active dissatisfaction to make it more convenient to change firms than
to remain at the current one.

NA5 is the only company that criticized their accountant or audit firm for anything
except the price. As NA5 also is the respondent with the least personal connection to
their accountant, this is quite interesting in association with previous studies on
attitudinal loyalty as an outcome of affective commitment (Čater & Čater, 2010,
p.1325). That the other companies do not criticize their auditor or accountant might not
be connected directly to satisfaction of the service, but instead to attitudinal loyalty
based on affective commitment that arose from good relationships. Satisfaction of the
service is one of the building blocks of affective commitment (Agariya & Singh, 2011,
p.228), where many of the blocks go into each other. This makes it difficult to know
what aspect of a relationship has what outcome, if that kind of distinction ever can be
made. In this case, lack of attitudinal loyalty is the most likely explanation for NA5’s
criticism as well as their refusal to recommend their accountant or audit firm.

NA6 is most vocal when criticizing their most recent former auditor, and is dissatisfied
with the lack of information on how the company could have benefited from an auditor.
NA6 sees this lack of information as bad service, and there was therefore no increase in
the affective commitment that would have accompanied a high service quality (de
Ruyter & Wetzels 2009, pp.68-70). NA6, along with the other NA companies, can be
said to not use the services of an auditor because they are satisfied with the services by
their accountant and do not see any necessary services being provided by the auditor.
For instance, the advisory needs of the NA companies were fulfilled by the accountant,
although both NA5 and NA6 state that they would like to receive more such services.

Furthermore, NA6 is an interesting example of loyalty in the matter of service quality.
They almost chose to go with their former accountant when the audit firm was sold,
even though the accountant had made at least one major mistake in the past. As NA6’s
primary relationship was with the auditor at the previous firm, they took the advice of
the auditor and did not go with the former accountant (it was not possible to go with the
auditor). NA6 noted that the current accountant also makes mistakes, but seemed not to
be bothered by them and this was no reason to terminate the business relationship.
These are examples of behavioral loyalty as explained by Čater and Čater (2010,
p.1325), also stemming from affective commitment (Čater & Čater, 2010, p.1330)

As our respondents have minute grounds to compare service quality, we have little to go
on in this section. The NA and AU companies all found the range of services, from
general bookkeeping to more specific consulting, to be of importance to them. We
believe that this is an important service to offer micro-entities as they normally do not
possess these types of skills within the company. It is the person who delivers these
services that the companies have built relationships with, regardless of it being an
auditor or an accountant.

Our respondents did not speak about satisfaction in the relationship as much as they did
of dissatisfaction, which we believe is a determinant for dismissing the auditor or
changing firms. To receive adequate service from someone with whom one does not
have a bad or non-existing relationship, seems to be enough to stay in the relationship
out of convenience. However, receiving more in-depth services, such as advisory, seems
to build a closer relationship, which is consistent with studies that show
interdependence as one of the foundations of affective commitment (Čater & Čater,
2009, pp.1154-1155). Again, we see that the parts that researchers have divided
affective commitment into are much intertwined.

5.9.2 Trust
All respondents express trust in the professional they have decided to keep working
with. This is not surprising, as it is hard to believe anyone would leave their or their
company’s finances in the hands of someone they do not trust. Five of our respondents
did not think that there was opportunistic behavior from their auditor, and those who
thought that such behavior might occur (AU1, AU3, NA3, NA4, NA5, NA7) still
believed that this type of behavior would not impact them in a negative way. As this is
in accordance with Schakett et al. (2011) our impression that the respondents trust their
auditors or accountants has support from previous studies.

All respondents but AU3 discussed the retention of the auditor with their/an auditor
(AU1, AU2, NA3, WA1) or accountant (all other respondents). As we have previously
stated, the respondents take advice from the person that they have the closer relationship
and also in this case took the advice of the professional they spoke to when deciding on
voluntary audit. This is in line with the findings of Collis (2012) as well. We believe the
choice of advisor demonstrates a higher level of trust in that person regardless of their
professional title. NA3 took the advice of their auditor, but it is interesting to note that
they had at that time a new accountant and therefore had relied more upon the auditor.
The next fiscal year, after working with the new accountant for a longer period of time,
they decided to dismiss the auditor. This indicates that the relationship between the new
auditor and NA3 has replaced the relationship with the auditor as the primary one.

NA2, NA4, NA5, NA6 and NA7 all had auditors and accountants from the same audit
firm, this did not prevent their accountant from stating that they saw little or no need for
an auditor in the companies, which can be interpreted as altruistic behavior. NA5 also
used this as an example of the honesty they perceive from the accountant. That all the auditors who were asked about voluntary audit said that the companies should keep their auditor might be construed as opportunistic behavior, if, as most of our respondents believe, it is unnecessary to have auditors in micro-entities. However, this does not seem to have had the negative effect on behavioral loyalty that previous studies suggest (Gounaris, 2005, p.136) as the AU group has no intentions of dismissing their auditors.

WA1 is the only case where the auditor recommended against having an auditor. As the auditor in this case is a close family member, who would most likely not be paid for his services even in a formal business arrangement, and also helps the respondent with their needs as it is, we believe that the auditor might have looked at this from a personal rather than professional angle. To formally be the auditor of WA1 would cause more work and no additional benefits for either party.

5.9.3 Interdependence
All respondents (except AU1 and WA1) state that they have more regular contact with their accountant than their auditor. The difference between the groups is that the NA group, aside from NA3, stated that they had little or no contact with their auditor during the year. Without this contact, there cannot be said to be any co-operation between the auditor and client. Aside from advisory provided by the auditor, NA3 also sold their professional services to their auditor. The more contact, the stronger positive effect on the relationship (de Ruyter & Wetzels, 1999, p.68), which is also implied in the contact pattern as the respondents remained clients to the professional they had more contact with.

All respondents but AU3 and NA2 replied to the question of adaptation that they believe their auditor (AU) or accountant (NA) adapt at least slightly to their companies’ needs. NA2 was certain the accountant did not adapt, but with their long professional and personal relationship we do not think this would matter in NA2’s loyalty intentions. AU3 did not think their audit firm adapted to their company, but also stated that the auditor and respondent had individual business arrangements to their mutual advantage. In our view, this would be a definitive adaption but is not something the respondent consciously put in relation with the question.

NA3 believed their accountant adapted, but had knowledge of the auditors work habits and did not perceive any auditor adaptation for their company. They were the only NA respondents with any familiarity with their auditors work routine and the only NA respondents who sold their own services to the auditor, which is interesting because they were also the NA respondents who voluntarily kept their auditor during the past year. The other NA respondents who dismiss their auditor in 2012 were not able to do so during the last fiscal year due to legislative reasons. Although building a case with only one company is weak, we believe there might be a link between the interdependence between NA3 and their auditor and their reluctance to dismiss the auditor in the first year. While AU3 also could be perceived to be interdependent with their auditor, there are many more compelling factors for why they kept their auditor.

5.10 Calculative Commitment
We found the AU companies comfortable in their worked-in relationships with their auditor, and the inconvenience of changing auditors or audit firms could be seen as a
calculative commitment. However, they express more positive attitudes to their auditor relationships which according to previous studies would cancel out the effect of calculative commitment on loyalty (de Ruyter & Wetselz, 2009, p.69).

NA5 is the only other respondent who talked about staying with a firm due to perceived difficulties, other than familiarity, in changing firms. They considered that in the small town, people might be more likely to take offense by this kind of disloyal behavior. A paper by Svanström and Boter (2012) shows support for NA5’s reasoning as the authors theorize that there are more negative consequences in dismissing an auditor in Norrland than in Stockholm, due to relationship reasons. As other respondents have cited personal connections to other service providers as a reason to change audit firms, and NA5 are newcomers to Skellefteå and cannot therefore justify a change of firms with this type of connection, we think that their calculative commitment is higher. They also show less affective commitment, which is in line with a higher calculative commitment.

5.11 Further Relevant Findings

5.11.1 Other Determinants of Voluntary Audit

As we chose to focus our study on business and relationship factors based on previous research in SMEs and relationship marketing, we assumed that the determinant(s) of voluntary audit would be found in one or both of these fields of study. However, as we used a grounded theory approach, we were open for other possible contributing or determining factors. The most convincing determining factor we found in the choice of voluntary audit was the advice from the auditor or accountant. This is also consistent with the findings of Collis (2012) who found the same correlation for micro-entities in the UK.

We further assumed that this decision would be based on conscious consideration. During our research, we did not find any indication of a weighing of the pros and cons of audit. We rather got the impression that the AU group kept their auditor out of convenience and the NA group dismissed their auditor due to their perception that there were no benefits for them as micro-entities which was also confirmed by their accountants’ advice to discharge the auditors.

5.11.2 The Perception of the Functions of Audit

All respondents perceived the main function of audit to be an external control mechanism, mostly beneficial to external parties such as the government and tax office, not to their own companies. The audit was also seen as an extra control function for the work of the accountant, so that no mistakes would be made. Only one respondent (NA5) could spontaneously mention other functions of audit, and then only one other function. As the respondents are not aware of any other functions of audit, it is easy for them to make an intuitive cost-benefit analysis as they see only cost, and no benefit. Their replies indicate further, that contrary to the traditional agency conflict within the firm, the perceived function of an audit is to correct a new form of information asymmetry. Instead of agent and principal as management and owner, a control need between owner and government institutions, mainly the tax office, was emphasized by our micro-entities. This matches our expectations and the findings of Niemi et al. (2012), that due to their small size, micro-entities have no need of control within the firm but are concerned with providing assurance and control to interested external parties.
Chapter 6: Conclusions, Limitations and Recommendations

This chapter presents our conclusions of the determining factors for micro-entities in Skellefteå in their choice of voluntary audit. It further states the limitations of the study which explain why the study is not generalizable and the recommendations to continue this line of research.

6.1 Conclusions

The purpose of our thesis was to find the determining factors for voluntary audit in micro-entities by conducting a qualitative interview study on micro-entities exempted from statutory audit in Skellefteå. Based on previous literature on the nearby topic voluntary audit in SMEs and relationship marketing, that we assumed would have an influence on the choice of voluntary audit, we found a research gap as little research was available on micro-entities. We found no research about determinants for audit in micro-entities until after our empirical study was complete, and even then there was only one study (Collis 2012) on the subject. This study was conducted in the UK, where the thresholds for audit exemption are much higher than in Sweden. Although the additional study added strength to our findings, the differences between the legislation on audit exemption in the UK and Sweden still allows us to categorize our study as exploratory.

The determining factor for retaining or dismissing the auditor from the micro-entities in our sample was the advice given from the professional auditor or accountant. Many of our respondents found the audit exemption liberating, but the decision to retain or dismiss the auditor was made after seeking, and in accordance with, the opinion of the auditor or accountant. The four auditors who were asked told their clients to keep the auditor, and the six accountants who were asked told their clients that it was not necessary to keep the auditor.

In regards to external demands for audited financial statements from banks and business partners, we found partial support that the business managers perceived this as a contributing factor to retain or dismiss an auditor, however not in companies as small as theirs that also had little or no debt. The perception of the business managers was that for compliance with accounting legislation and tax purposes, an auditor could be beneficial but the assurance provided by a professional accountant was sufficient for seven out of ten respondents.

There is no support that separation of ownership and management in the Swedish micro-entities exempted from mandatory audit has any relevance for the choice of voluntary audit. This is due to the fact that there is no such separation in our sample, and considering the size of the threshold values it is unlikely that there are many micro-entities that have this kind of separation and thereby no need for an audit as an internal control check.

The three companies that retained their auditor all used the auditor as a financial consultant, whereas those companies who dismissed their auditors received the same services from their accountant. Thereby, we could find no evidence that the business managers in the non-auditor group were aware of any benefits from having an auditor that could not be achieved through an accountant.
For the audit group, there is a clear perception from two out of the three companies that the good relationship between them and the auditor affected the decision to retain the auditor in the company. For the companies that dismissed the auditor, there does not seem to be a relationship between the business managers and the auditors, which could therefore not have affected the decision to dismiss the auditor. The lack of such a relationship, however, seems to have been the reason why the business managers sought the advice of their accountant with whom there existed a relationship.

Our assumption, which was based on our previous knowledge in auditing and business administration, was that as entrepreneurs the respondents would have a more thorough understanding of the financial side of running a business. Included in this understanding, would then be a basic knowledge of the difference between an accountant and an auditor. We also assumed that both would be advantageous to have within a business, even a micro-entity. However, if one is to trust the professional opinion of the accountants in the micro-entities, that have dismissed their auditors, there is little or no need for auditors in micro-entities.

6.2 Limitations and Recommendations

The scope of our study was limited to Skellefteå which makes it difficult to draw a valid conclusion beyond that regional restriction. Furthermore, the sample size is eleven companies which do not allow us to generalize the findings to all audit exempted micro-entities in Sweden. The perceptions and opinions collected in our study are one-sided, thereby only reflecting the point of view of the business managers in our sample, neglecting other important views regarding determinants of voluntary audit from external parties. In addition, due the lack of previous literature about micro-entities and our exploratory research approach, the interview questions were based on studies on SMEs, which have larger size criteria. Thereby, it is possible that we missed decisive factors for our research purpose in the theoretical framework and therefore in the ongoing process of our study.

Further research can therefore extend the sample size to allow for greater generalization and solid conclusions for micro-entities in Sweden. In addition, a larger geographical spread would be favorable to explore possible regional differences of micro-entities’ perception in Sweden. Further studies should also include point of views of external parties of the micro-entities. Our findings suggest that the opinions of auditors or accountants, banks and governmental institutions such as the tax office would contribute to a better understanding of determinants of voluntary audit in micro-entities and would allow for a comparison between the perceived and true demands in regard to audit from various external parties. Moreover, we believe that the consulting function of an auditor or accountant needs to be investigated further as this was seen as a crucial determinant for service quality and continuance of business relationships in our micro-entities.

As a recommendation to auditors, we emphasize the importance of informing the clients of the functions and benefits of audit and having an auditor. To build a relationship with some form of personal connection also seems to have an impact on auditor retention in micro-entities, whereby we recommend the auditors to interact more with their clients.
References


Appendix
Interview Questions

General Questions

- Name/Age/Title (names and company names will not be revealed)
- What was your first thought when you heard that your company would be exempt from audit?
- Tell us in your own words how you decided to retain or dismiss your auditor. (Prompting: did you weigh the pros and cons of having an auditor? What were these? Did you talk to your auditor about this? Did you talk to someone else about this decision? What did they say? Do they have any connection to your auditor?)
- What do you think is the function of auditing?

Business Factors

- Do you think auditing is a control mechanism for internal control? Why/why not?
- Do you think auditing is a control mechanism for management? Why/why not?
- Do you consider your creditors or bank when deciding to retain your auditor?
- Do you think that audited financial statements matter to outsiders such as creditors/suppliers/banks?
- Have there been any changes in the term of loans/deliveries after choosing to dismiss your auditor? Interest rates, terms of payment and so on.
- Do you consider if a company has audited financial statements before investing or doing business with them?
- What educational background do you have? (Any accounting/business?)
- To what degree do you participate in accounting activities? (What do you do?)
- Do you also purchase non-audit services from your auditor/auditing company? (Which/Why?)
- What are the benefits of an audit in general? What could be the benefits for you?
- Do you feel like you’ve had these benefits?
- How much do you think the benefits are worth? How much do you pay for audit? (More or less?)

Relationship Factors

- Do you have one auditor that you work with? If not, do you have anyone in particular in the audit firm that you work with?
Do you know this person in a social setting? Do you know someone from the firm in a social setting?
  o Do you socialize, in what context?
  o If not, do you/would you talk to him/her if you met in a social context
  o If not, do you think he/she is the kind of person you could be friends with?
    (Remember, we don’t know who this is and the answers are anonymous.)

What kind of interaction do you have with your contact from the audit firm?
  o We talk only of work
  o We talk of other things/general things as well

What would make you want to change auditor?

If you’ve had other auditors, do you perceive any difference in the quality of the work? If so, what kind of difference and how did you notice this?

Do you think your auditor might have personal interests that would affect the work s/he does for you?

Do you think your auditor/contact at the audit firm adapts their way of operating to suit your company?

Have you recommended your audit firm to others?