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Audit office size, audit quality and audit pricing: evidence from small- and medium-sized enterprises

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Abstract

Using Swedish data, we investigate the relationship between audit firm and audit quality. We find that larger audit firms are associated with higher audit quality. We also find that audit firms in Sweden are more likely to be Big 4 audit firms (PwC, Deloitte, EY and BDO). These results suggest that audit quality is differentiated in the private segment market.

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However, contrary to prior studies, our results suggest that the important dimensions are Top 6 versus non-Top 6 and the office size of non-Top 6 audit firms.

Keywords: audit fees audit offices audit quality private companies disciplinary sanctions
Top 6 audit firms

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Notes

Disciplinary action may of course also be taken against auditors of publicly held companies. However, the vast majority of all disciplinary cases are related to audits of privately held companies.

The average number of audit assignments held by auditors-in-charge in Sweden was 123 in 2008.

Small firms (with fewer than 10 employees) are not allowed to be public limited companies. Small firms with fewer than 10 employees have not exceeded the threshold of 4.4 million SEK in revenue or 50 employees. The average number of employees in small firms was 12 in September 2008.

The government has introduced a new classification of firms into three size categories based on revenue and number of employees. The following table shows the classification criteria for the three size categories. Small firms have a maximum revenue of 3 million SEK and a maximum number of employees of 50. Medium-sized firms have a maximum revenue of 10 million SEK and a maximum number of employees of 250. Large firms have a maximum revenue of 100 million SEK and a maximum number of employees of 2500.

an average number of full-time employees of three. If auditing is no longer required, the general meeting should actively take a decision not to have an audit.

Auditing is also required in 21,200 trading partnerships, 15,000 foundations, 1530 foreign branches, 270 insurance companies, 75 banks, 70 economic associations, 15 non-profit organisations, 5 sole proprietorships and 4 European companies (SOU [2008:32](#), p. 124).

In 2006, the two institutes for public accountants in Sweden, Föreningen Auktoriserade Revisorer (FAR), and Svenska Revisorsamfundet (SRS), merged. From September 2006 until March 2010, they used the name FARSR. Since March 2010, this Institute has been called FAR.

In addition to these types of auditor, there are auditors who have gained approval without taking an examination. Such auditors are allowed to audit small firms over a transitional period.

Reported revenues in Sweden for Öhrlings PwC, Ernst & Young, KPMG and Deloitte were 10.383 billion SEK (1 EUR = 8.81 SEK, as of 21 February 2012).

Reported turnover for the largest 10 audit firms in 2009 (in Euros): (1) PricewaterhouseCoopers 471 million, (2) Ernst & Young 296 million, (3) KPMG 218 million, (4) Deloitte 148 million, (5) Grant Thornton 97 million, (6) BDO 60 million, (7) SET Revisionsbyrå 34 million, (8) Baker Tilly 18 million, (9) Nexia 6 million and (10) Rödl & Partners 6 million.

Among the largest audit firms in Sweden, Ernst & Young 6.3 billion SEK.

The quality of audits is regulated by the EU.

In the period 2007-2009, 7 (26.3%)

were the result of tips

from (6) based on

tips from

The SBPA 2009 (SBPA

Annual Report 2009 the cases led

to the imposition of sanctions.



From 2005 to 2009, the average number of approved and authorised auditors was 4083.

Note that Palmrose ([1988](#)) investigated litigation cases against auditors, not disciplinary sanctions.


During the 1970s and 1980s, there were eight big audit firm networks ('Big 8'). Two big mergers in 1989 reduced the group to 'Big 6'. This became 'Big 5' when Coopers & Lybrand and Price Waterhouse merged in 1998. Since the disappearance of Andersen in 2002, the current large audit firms have been referred to as 'Big 4'.

The following switches of employees were identified. One auditor who had worked for a Big 4 audit firm had switched to a small firm and one auditor who had worked for a small audit firm had switched to a Big 4 firm. Two auditors who had worked for Grant Thornton or BDO switched to small audit firms. Finally, there were a few switches between small audit firms. The few switches indicate that the data at the end of 2009 were also representative of the situation prior to 2009.

Exchange rate at 21 February 2012.

This is the age of the auditors without a sanction in 2007; the mean and the median year of the sanctions in the sample are 2007.

We also ran the regressions in [Table 4](#) separately for Big 4 auditors and for auditors employed by Grant Thornton and BDO. The office size measures were insignificant in all these regressions.

Indeed,  have more audit as... es. We received... 5 auditors in our sam... ation agency... ne age of the a... ore exposed to audit... dditional variable... are still significant... Also had positive... regressions in [Table 4](#) v... nts for auditors who had lost their certification was not available.

Tables with industry distribution for the audit fee sample, descriptive statistics and a correlation matrix for included variables in the audit fee regression models is available upon request from the authors.

We also calculated the variance inflation factor (VIF) in order to examine whether multicollinearity significantly influenced our empirical results. The highest VIFs in the regressions in [Table 6](#) were 5.28 and 6.69 in [Table 7](#), thus suggesting that multicollinearity is not a problem.

We ran the regressions separately on Big 4 audit firms and Grant Thornton or BDO. LNOFFICESIZE had a positive coefficient significant at the 0.10 level in the regression on the 97 observations audited by Grant Thornton or BDO and a positive but insignificant coefficient in the regression with Big 4 audited companies in the sample.

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