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Home ▶ All Journals ▶ Economics, Finance & Business ▶ Accounting and Business Research ▶ List of Issues ► Volume 43, Issue 1 ► Audit office size, audit quality and aud ....

Accounting and Business Research > Volume 43, 2013 - Issue 1

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**Original Articles** 

# Audit office size, audit quality and audit pricing: evidence from small- and mediumsized enterprises

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between the likelihood of sanctions and audit office size for non-Top 6 auditors. This

association is insignificant for Top 6 audit firms. Audit fees follow a similar pattern and indicate that larger audit firms and offices put in more effort or have greater expertise. These results suggest that audit quality is differentiated in the private segment market. 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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The governmental decision means that companies not exceeding two of the following three size criteria are exempted from the audit requirement: a net turnover of 3 million SEK (1 EUR = 8.81 SEK, 21 February 2012), a balance sheet total of 1.5 million SEK and 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 Revsiorsamfundet (SRS), merged. From September 2006 until March 2010, they used the name FARSRS. 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 I X Reported **Pricewat** G 218 million, nillion, (7) nd (10) Rödl **SET Rev** & Partne Among l, Ernst & Youn by the EU. The qua In the pe (26.3%)sult of tips were ini 6) based on from tax

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The SBPA opened a total of 674 disciplinary investigations from 2005 to 2009 (SBPA Annual Report, various issues). Two hundred and ninety-five or 44% of these cases led to the issuing of disciplinary sanctions. Thirteen auditors received multiple sanctions. From 2005 to 2009, the average number of approved and authorised auditors was 4083.

Note that Palmrose (<u>1988</u>) 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.

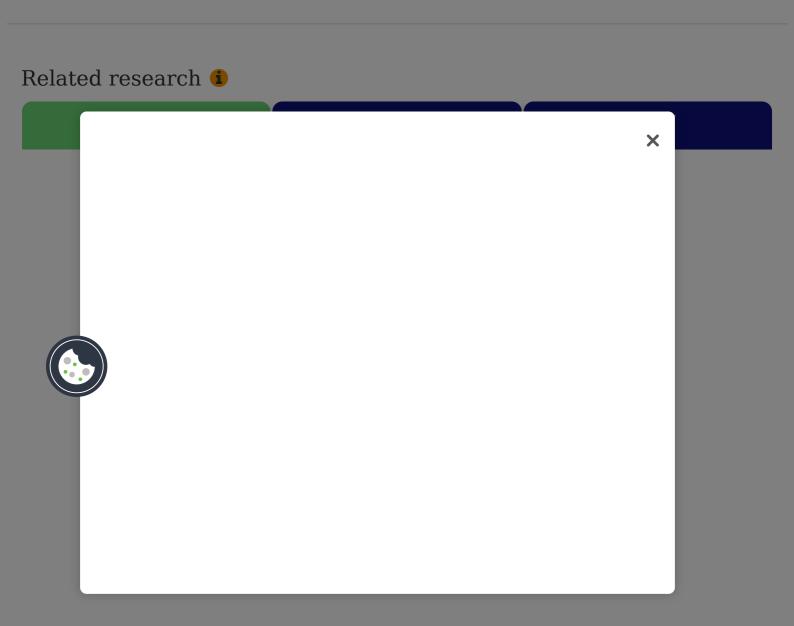


positive coefficients significant at the 0.01 level in the regressions. The regressions in Table 4 were only run on three outcomes, because the number of assignments for auditors who had lost their certification was not available.

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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