

Directors' Views on Exemption from the Statutory Audit

A Research Report for the DTI

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Executive summary

Introduction

This study was commissioned by the DTI in February 2003 and supports the government's stance on evidence-based policy making. The aim of the research is to investigate issues in connection with audit exemption by examining the views of the directors of private limited companies that fall within the EC size thresholds for a small entity. The main issues investigated are take-up levels of audit exemption, cost savings and the factors that have a significant influence on the directors' decision regarding a voluntary audit if thresholds in the UK were raised to the EC maxima. At the time of the study these were turnover £4.8m, balance sheet total £2.4m and number of employees 50.

The level at which the audit exemption threshold should be set is an important aspect of a wider debate on the need for different sets of generally accepted accounting principles for large and small entities, known as the big GAAP/little GAAP debate. Proposals to raise the size thresholds for audit exemption to the EC maxima have resulted in controversy, but to a large extent the discussion has been based on anecdotal evidence from policy-makers and the accountancy profession.

The opinions of the directors of small companies are important, as there is very little up-to-date generalisable evidence from their perspective on the value of the audit. It has been known for some time that they are the main users of the statutory accounts and recent research shows that they use the accounts for a range of internal and external purposes. The directors' views are vital to the audit debate, since they must weigh up the costs and benefits to the business and, of course, they bear the cost of the audit.

Design of the Study and Sample Selection

The research was designed as a large-scale postal questionnaire survey, preceded by a small number of preliminary interviews with auditors and small company directors to develop the questionnaire. In April 2003 it was sent to 2,633 active, independent, unlisted, private limited companies with a turnover not exceeding £4.8m, balance sheet total not exceeding £2.4m and up to 50 employees. These were the EC maxima for a small company at the time of the study, which was conducted prior to a subsequent increase due to indexation in May 2003. Since companies filing abbreviated accounts do not disclose turnover information, which was considered to be a key variable in the study, the sample consisted solely of companies filing full accounts.

Usable replies were received from 790 companies, giving a response rate of 30%. Tests for non-response bias found that non-respondents were likely to have been smaller in terms of number of employees. This indicates that the sample contained fewer companies with no employees or very few employees compared with the population. However, in terms of turnover and balance sheet total, tests showed that the sample was representative of the body of companies from which it was drawn.

Characteristics of the Sample

In 94% of cases the questionnaire was answered by the principal director, finance director or company secretary. The position and the educational profiles of the respondents suggested they would have both tacit and formal knowledge with which to answer the questions and weigh up the costs and benefits of the audit when making the audit decision.

The directors perceive the main benefits of the audit as providing a check on accounting records and systems (65% agree), improving the credibility of the financial information (61% agree) and providing assurance to the bank (58% agree). In addition, 50% of respondents consider the audit helps protect against fraud and 43% consider it improves the quality of the information.

As in the wider population, the majority of the sample companies were at the smaller end of scale in terms of ownership and size. The vast majority (90%) have between one and four shareholders and 68% are wholly family-owned. In 74% of cases all shareholders have access to internal financial information, which implies that the majority are owner-managed. In terms of size, 80% had a maximum turnover of £1m in their 2002 accounts, 89% had a maximum balance sheet total of £1.4m and 78% had between 0 and 10 employees.

A large proportion of companies (44%) have external funding in addition to the capital invested by the shareholders and retained profit. The main source of finance is from the bank (69%) and 52% use asset-based finance. Personal loans from family or friends are sources of finance in 38% of companies. Tests found that the larger the turnover, the more likely the company is to have external funding. In 55% of cases where the company has external funding, the directors had been required to give a personal guarantee. Only 1% of the sample plans to obtain a stock exchange listing in the foreseeable future.

In 31% of companies a qualified accountant is employed in a financial role in the business. However, in the vast majority (85%) an external accountant normally prepares the statutory accounts. Using a turnover of £2.8m as a proxy of eligibility to prepare the accounts according to the Financial Reporting Standard for Smaller Entities (the FRSSE), it was found that 67% of respondents reported doing so in their 2002 accounts.

In a large proportion of cases the external accountant also provides tax services (65%), audit services (48%), additional detailed annual accounts (36%) and/or advice in connection with the annual results (33%). Ten years was the typical length of time the external accountant had been auditing the accounts and the typical fee disclosed in the 2002 accounts was £1,000.

The majority of companies give a copy of their statutory accounts to the Inland Revenue (56%) and just over half (51%) give them to the bank and other providers of finance. The proportion of those providing statutory accounts to support tax computations may be higher than the reported figure, as this may be dealt with by the accountant or other tax adviser.

Take-Up of Audit Exemption

Using a maximum turnover of £1m as a proxy for eligibility, 58% of the sample companies took up audit exemption in their 2002 accounts compared with 42% who filed audited accounts.

The main reason for filing unaudited accounts in 2002 was lower accountancy fees, but very few directors were able to report the specific amount saved. Of those that did, the typical reduction in fees was £1,000. The inability of the directors to report the actual amount saved implies that it may not have been a significant saving or that it was offset by other charges. The latter is a logical explanation, as it was apparent from the preliminary interviews with auditors that there is often considerable overlap between time spent on accounts preparation and time spent on auditing the accounts.

The main reasons for filing audited accounts in 2002 were the desire to do so (46% of those responding) and the continuation of company policy (38%). The main users requesting the accounts to be audited in 2002 were shareholders (30% of those responding) and the bank and other providers of finance (27%).

The proposal to raise the audit exemption threshold to £4.8m is supported by 57% of the sample companies. If the requirement for a statutory audit were removed, 42% of companies predict that they would have the accounts audited on a voluntary basis, compared with 56% who would discontinue the audit (2% did not respond). Among companies that would be eligible for exemption for the first time (ie those with a turnover above £1m), the majority (79%) predict that they will have a voluntary audit.

The main reasons given by those predicting that they would opt for exemption were that there would be no benefit in having the accounts audited (44% of those responding) or that there would be cost savings from discontinuing the audit (42%).

The main reason given by those who predicted that they would have a voluntary audit was that it provides a check/assurance for third parties (70% of those responding).

Influences on the Voluntary Audit Decision

Analysis of the factors that have a significant influence on the audit decision reveals that the directors are more likely to have a voluntary audit if the company has the following characteristics: It is larger in terms of turnover and the directors consider that the audit improves the quality of the financial information, has a positive effect on the company's credit rating score and provides a check on accounting records and systems; and it is not wholly family-owned and has shareholders without access to internal financial information; and the directors normally give a copy of the statutory accounts to the bank and other providers of finance.

Turnover represents the cost burden in the analysis. Thus, the larger the turnover, the lower the relative cost. To some extent, it can be argued that turnover also captures whether the company is large enough to have external or

non-family shareholders and external borrowings. However, these factors are better explained by the theory that the directors will be willing to bear the cost of the audit because of their beliefs about the benefits of the audit and the role the audited accounts play in reducing the cost of capital and supporting agency relationships (with shareholders and lenders) where there is information asymmetry.

Implications of the Findings

The sample of 790 companies is sufficient to represent the population, as it greatly exceeds the minimum acceptable sample size of 384. This, together with the satisfactory response rate of 30%, allows the findings of this research to be generalised to other independent, unlisted, private limited companies filing full accounts with a maximum turnover of £4.8m and balance sheet total up to £2.4m.

The findings confirm and extend previous research and should be of interest to policy-makers, the accountancy profession and others who advise small companies. They should also be of interest to the owners and directors of small companies themselves, academics and other researchers.

The study provides evidence that size is not a sufficient measure on its own for capturing the costs and benefits of the audit. There are other qualitative factors that have a significant influence on the directors' decision on whether or not the accounts will be audited on a voluntary basis.

The finding that the vast majority of companies (79% of those that are likely to be eligible for exemption for the first time if the turnover threshold is raised to £4.8m) predict that they will have a voluntary audit will be reassuring to small practitioners who rely on audit fee income from small company clients. It will also be reassuring to lenders and other providers of credit who rely on audited financial statements for assessing risk. However, these parties have the economic power to ensure that their requirements are met and it is important that future regulation continues to protect the needs of shareholders requiring the additional assurance of an external audit.

If thresholds in the UK are raised to EC levels, policy makers should be aware that the new category of small companies would contain two subgroups with differing needs. This is demonstrated by the significant proportion of directors whose audit decisions indicate that the benefits outweigh the costs. This heterogeneity should also be taken into account by those who contribute to the development of differential reporting on the basis of size at the international level.

1 Background to the Study

Introduction

- 1.1 This study was commissioned by the DTI in February 2003 and supports the government's stance on evidence-based policy making (Cabinet Office, 1999). The aim of the research is to investigate issues in connection with audit exemption by examining the views of the directors of private limited companies that fall within the EC size thresholds for a small entity. The main issues investigated are take-up levels of audit exemption, cost savings and the factors that have a significant influence on the directors' decision regarding a voluntary audit if thresholds in the UK were raised to the EC maxima. At the time of the study these were turnover £4.8m, balance sheet total £2.4m and number of employees 50.
- 1.2 The question of the size of company that should be exempt from the statutory audit is an important aspect of a wider debate on the need for different sets of generally accepted accounting principles (GAAP) for large and small entities. This has become known as the big GAAP/little GAAP debate. Proposals to raise the turnover threshold for audit exemption (DTI, 2000) have resulted in controversy, but to a large extent the discussion has been based on anecdotal evidence from policy-makers and the accountancy profession.
- 1.3 The opinions of the directors of small companies are important, as there is very little up-to-date generalisable evidence from their perspective on the value of the audit. It has been known for some time that they are the main users of the statutory accounts (Page, 1984, Carsberg, Page, Sindall and Waring, 1985, Barker and Noonan, 1996) and recent research shows that they use the accounts for a range of internal and external purposes (Collis and Jarvis, 2000). The directors' views are vital to the audit debate, since they must weigh up the costs and benefits to the business and, of course, they bear the cost of the audit.
- 1.4 Since July 2000, most limited companies that qualify as 'small' under UK law and have a turnover of £1m or below are not required to have their accounts audited,¹ but the government proposes to raise the ceiling, possibly to the maximum allowed under EC law (DTI, 2000). This links with a second proposal to increase the size criteria in UK law for qualification as a small company to the EC maxima. Table 1 compares the size criteria for defining a small company under UK law with the higher European Commission (EC) levels as they were at the time of the study. The thresholds are revised every five years to take account of economic and monetary trends and in 2003 the EC approved a proposal to increase the turnover and balance sheet total thresholds by 16.8% from 15th May. The revised maxima are shown in the last column of Table 1.

¹ Most of the requirements of company law also apply to limited liability partnerships, a new form of business vehicle permitted since April 2001.

Table 1 Size Criteria for a Small Company

Criteria	UK thresholds	EU maxima at time of study	EU maxima from May 2003
Annual turnover	£2.8m	£4.8m	£5.6m
Balance sheet total	£1.4m	£2.4m	£2.8m
Average number of employees	50	50	50

- 1.5 Under UK law, apart from certain companies that are excluded for reasons of public interest, a company qualifies as small if it meets two of the three criteria shown in the above table in any year. For companies other than newly incorporated companies, the conditions must have been satisfied in two of the last three years.

Role of the Audit

- 1.6 An audit is 'an independent examination of, and the subsequent expression of opinion on, the financial statements of an organization' (Hussey, 1999, p. 33). The audit can be viewed as an integral part of corporate financial reporting, where the assurance it provides stems from the trust placed in the judgement of the auditor. The audit is designed to demonstrate 'the completeness, accuracy and validity of transactions which, when aggregated, make up the financial statements' (Power, 1997, p. 24).
- 1.7 The auditor must plan the audit to provide a reasonable expectation of detecting material misstatements (APC, 1990), but searching for fraudulent practices is not the duty of the auditor (Elliot and Willingham, 1980). Some contend that responsibility for the prevention of fraud rests with management, through internal systems of supervision and control (Pound and Curtis, 1980), but Woolf (1996) argues that there is some overlap, as material fraud is likely to affect the true and fair view verified by the auditor.

Development of Differential Audit Requirements

- 1.8 In the UK, differential financial reporting for companies of different sizes developed in the early 1990s, when smaller companies were offered a regulatory framework with some simplifications and concessions from generally accepted accounting principles (GAAP). The regulatory framework for smaller reporting entities became known as little GAAP.
- 1.9 The EC Fourth Company Law Directive (also known as the Accounting Directive) permitted national governments to dispense with the requirement for smaller entities to undergo an audit. This led to an amendment of section 249A of the Companies Act 1985 in 1994 (SI 1994/1935) to exempt qualifying small companies with a turnover up to £90,000 and a balance sheet total up to £1.4m. It is important to note that this turnover threshold was lower than the level set in the Fourth Directive. Unless a full audit was required by at least 10% of shareholders, a company with a turnover of between £90,000 and £350,000 was able to dispense with the audit, but had to have an accountant's report. In 1997 the turnover threshold was raised to £350,000 (SI 1997/936), with the balance sheet total remaining at £1.4m. However, the company also had to qualify as

'small' for the purpose of filing abbreviated accounts.² In 2000 the turnover threshold was increased to £1m (SI 2000/1430) and the government put forward a proposal to raise the small company size thresholds, including audit exemption, to the EC levels shown in Table 1 (DTI, 2000).³

Structure of the Report

- 1.10 The second chapter in this report contains a review of the literature relating to the small company audit in the UK, and this provides a theoretical framework for the study. Chapter 3 presents the research questions addressed by the research and describes the methodology employed.
- 1.11 The first of the survey results is given in Chapter 4. These include a profile of the respondents and their views on the value of the statutory audit. In addition, the key characteristics of the sample companies are described in terms of management, ownership, size, financing, financial reporting, accountancy and agency relationships.
- 1.12 Chapter 5 presents the results relating to the take-up of audit exemption by examining the decision made by the directors in the 2002 accounts and their likely decision if the company were to become exempt as a result of increasing the threshold to the EC level. In both cases the reasons for the audit decision are explored.
- 1.13 Chapter 6 contains further analysis of key findings in Chapters 4 and 5 using a logistic regression model based on a theoretical framework. This identifies the factors that have a significant influence on the decision to have a voluntary external audit of the statutory accounts.
- 1.14 The final chapter provides a discussion of the contribution of the study, the main findings and draws conclusions regarding the implications of the findings.

2 The options set out in Section 246 of the Companies Act (as revised by SI 1997/220) allow small and medium-sized companies to prepare and file either full or abbreviated financial statements with the Registrar, but they must provide full financial statements for their shareholders. Abbreviated accounts must be accompanied by a special auditors' report, unless the company is exempt from the requirement for an audit by virtue of sections 249A(1) or (2) or 250 of the Companies Act 1985.

3 In most EU countries the threshold is higher than in the UK (typically, £2m-£4m), but there are also legal and regulatory differences, as well as variations in the population and size distribution of business entities. These factors make inter-country comparisons problematic.

2 Review of the Literature

Introduction

- 2.1 This chapter provides a brief review of the theories, arguments and evidence relating to the small company audit. Differentiation in the size of company that should be required to have an audit implies that at a certain size the benefits outweigh the costs. Thus, the rationale for audit exemption is to relieve the unnecessary cost burden that the government argues falls disproportionately on small companies (DTI, 1995, 1999). However, the proposal to raise the size thresholds to the EC maxima has resulted in controversy over who will gain from such a move.
- 2.2 From the regulators' perspective, and that of the accountancy profession, the lack of information on the exact nature of the costs and benefits has limited the debate on the appropriate level for audit exemption (Collis, Jarvis and Skerratt, 2001a). To a great extent, discussions have been informed by anecdotal evidence, together with a small number of research studies. However, the dynamic nature of the regulatory environment in which financial reporting takes place means that the results of older studies often have little relevance. Moreover, much of the previous research has used too small a sample size to permit generalisations to be made (for example, Page, 1984; Freedman and Goodwin, 1993; Pratten, 1998; Lin-Seouw, 2001). Recent generalisable evidence on the net benefits of the audit comes from a PhD thesis by the author (Collis, 2003) from which a number of papers have been published. These include a logistic regression study by Collis, Jarvis and Skerratt (2001b⁴) and a report for the ICAEW by Collis and Jarvis (2000). The following literature review draws on this work.

Size Factors

- 2.3 An examination of the evidence relating to take-up levels offers key information relating to size as a factor for influencing the balance between the costs and benefits of the small company audit. A study of 171 companies⁵ conducted in 1979 before the Companies Act 1981 introduced a three-tier size classification of companies predicted that only 15% of companies would discontinue the audit, whilst 84% would continue to have their accounts audited (Page, 1984). However, the sample was not selected on the basis of any size criteria but across the range of active, independent companies. This, together with the passage of time before audit exemption was first introduced in 1994, makes comparison problematic.
- 2.4 Details of the actual number of companies that took advantage of exemption in the early years are not available, but the government has recently begun collecting statistics. These show that 14% of companies on the register in 2002/3 had filed full audited accounts, 9% had filed abbreviated accounts and 57% had filed full or abbreviated accounts that were audit exempt (DTI, 2003, Table F2, p.

4 This has been developed into an article for *Accounting and Business Research* and is currently being prepared for publication.

5 This study achieved a 41% response rate from 413 companies.

58). The remainder had filed group accounts, interim/initial accounts or were dormant. This information is difficult to interpret, as the percentages relate to the total business stock, rather than those eligible for exemption.

- 2.5 A MORI survey of 176 companies in 1998 forecast that approximately 40% of companies with a turnover between £350,000 and £1.5m were likely to opt for audit exemption if the threshold were raised to £1.5m (ACCA, 1998). Looking at companies with a turnover up to £4.2m, a survey of the directors of 385 independent, unlisted, private limited companies (Collis and Jarvis, 2000)⁶ found that 29% of companies would forgo the audit if they became exempt, whilst 63% would continue to have their accounts audited if the threshold was raised to £4.2m (the EC maximum at that time). Thus, the predictions of both studies suggest that the majority of smaller companies consider the benefits outweigh the costs.
- 2.6 The profession's views on the most appropriate level for audit exemption are diverse (for example, Acher, 1999; Graham, 1999; Langard, 1999; Masters, 1999). Among those in favour of raising the turnover threshold, Mitchell (1999, p. 21) argues that '92% of accountants responding to a Small Practitioners Association survey supported exemption for all private, owner-managed, small limited companies'. The ICAEW described the news that the threshold could be raised to the EC maximum as 'a positive step to ease the burdens on business' (Accountancy, 2003, p. 9). On the other hand, others in the ICAEW argue that raising the audit threshold reduces the quality of the information put on public record (Jones, 2003). The ACCA supports maintaining the present limit: 'The inescapable fact is that the government's proposals advocate the removal of the audit but not the requirement for the directors to deliver true and fair annual financial statements. Since 90% of the work is done by accountants in the compliance function, it is foolish to take away the value-added aspect which comes with the audit' (Beckerlegge, 1999, p.21). In the wake of Enron, the chief executive of ACCA also argues that raising the audit threshold will raise the risk of fraud (Rose, 2003).

Agency Factors

- 2.7 Agency theory (Jensen and Meckling, 1976) offers another factor that might influence the balance between the costs and benefits of the audit. The theory suggests that information asymmetry arises in companies where there is separation of ownership and control, and this leads to the demand for the accounts to be audited. The agency rationale is classically applied in large companies where there are external shareholders and the audited accounts play a stewardship role in the agency relationship between shareholder (the principal) and director (the agent). In small companies, a principal is anyone who is distant from the actions of management and is unable to verify them, such as external shareholders, lenders and creditors.
- 2.8 Previous research shows that the audited accounts of small firms are crucial to the banks for making lending decisions⁷ (Berry, Citron and Jarvis, 1987; Berry, Crum and Waring, 1993; Berry, Faulkner, Hughes and Jarvis, 1993; Deakins and

⁶ The study achieved a 17% response rate from 2,287 companies.

⁷ Banks are the main source of finance to small firms (Cosh and Hughes, 1998).

Hussain, 1994; ACCA, 1998). There is also evidence that this is one reason why the directors choose to have the accounts audited (Page, 1984; Lin-Seouw, 2001). Indeed, a telephone survey of 176 companies with a turnover of up to £1.5m found that 82% consider that the information provided within the statutory audit is useful to the bank (ACCA, 1998, Appendix, p. 3).

- 2.9 Information asymmetry may also be present amongst internal shareholders if they lack the necessary skills to interpret financial information (Power, 1997). Thus, demand for the audit from shareholders may not be dependent on size, since 'even in the very smallest company disputes can arise between shareholders and the audited accounts can be an essential protection' (Freedman and Goodwin, 1993, p. 128). Nevertheless, it can be argued that as most small companies are owner-managed and family-owned (Bolton, 1971; Poutziouris, Chittenden, and Michaelas, 1998; Collis and Jarvis, 2000), there is little value in having the accounts audited and this agency cost can be avoided if the company is eligible for exemption.
- 2.10 Simunic and Stein (1987) contend that agency costs increase in proportion to the size and complexity of the firm's operations. Therefore, such costs are expected to be less significant in small firms where operations are less complex than in large firms. Keasey, Watson and Wynarczyk (1988) argue that the cost of the universal application of the requirement to have the accounts audited falls disproportionately on small companies, particularly if the accounts are of little use to external users. This seems logical, as the proportion of fixed costs to variable costs is likely to be greater in small firms compared to large firms (Collis et al., 2001b).

Management Factors

- 2.11 In addition to size and external agency relationships, the demand for the audit may be attributable to management factors. Management may want an independent check on internal controls to reduce the chance of material error. In small companies inherent risk (the likelihood of a material misstatement arising) and control risk (the likelihood of the accounting control detecting any material misstatement) may be high.⁸ Indeed, Collis et al. (2001b) found that directors who would have a voluntary audit if they became exempt are likely to hold the view that the audit increases the quality of the information in the accounts and acts as a check on internal books and records.
- 2.12 Although Carsberg et al. (1985) established that the main use of the statutory accounts is for management purposes, particularly confirmatory purposes, their study did not explore the specific role of the audit in this connection. The MORI survey (ACCA, 1998) found that 40% of small companies consider that information provided by the audit is useful to the business itself, which suggests that the directors have a general perception that the audit provides net benefits. Page (1984) suggests that the directors would choose to have a voluntary audit for the efficient running of the company. Responses from 10 companies in a questionnaire survey by Pratten (1998) suggest several other reasons:

⁸ The standard formula for measuring audit risk is: $AR = IR.CR.DR$ (inherent risk, control risk and audit detection risk).

- their accountant had advised it;
- it is a discipline/good practice;
- for continuity with the past;
- for a profit-related pay scheme.

2.13 Collis et al. (2001b) found that directors with a degree, professional/vocational qualification or who had studied/trained in business or management subjects were more likely to choose a voluntary audit. This suggests that educational profile may be a proxy for formal knowledge of the costs and benefits of the audit.

3 Methodology

Introduction

- 3.1 This chapter examines the research design and the way in which the sample companies were selected. The study was designed as a postal questionnaire survey of the directors of unlisted, private limited companies across all industries and regions in the UK. It was intended to capture the views and practices of those that were likely to qualify as small under UK law at present, as well as those that were likely to be reclassified as small if the higher EC thresholds are adopted.

Research Questions

- 3.2 The aim of the study is to investigate views of the directors in connection with statutory audit and address the following research questions:
1. What are the take-up levels of the audit exemption option for companies with a maximum turnover of £1m?
 2. What are the cost savings for companies with a maximum turnover of £1m that have discontinued the audit?
 3. What are the likely take-up levels of the audit exemption option if the turnover threshold under UK law is raised to £4.8m?
 4. What are the factors that have a significant influence on the demand for the audit among companies with a maximum turnover of £4.8m?
- 3.3 The fourth research question is divided into nine hypotheses, which are presented below in the null form. The first hypothesis is based on size factors and the importance of turnover in the size qualification criteria in the Companies Act 1985:
- H1. Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases with size, as measured by turnover.
- 3.4 The next five hypotheses relate to management factors in connection with the directors' knowledge or beliefs about the costs and benefits of the audit:
- H2. Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases with perceptions that the audit provides a check on accounting records and systems.
- H3. Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases with perceptions that the audit improves the quality of the financial information.
- H4. Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases with perceptions that the audit improves the credibility of the financial information.
- H5. Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases with perceptions that the audit has a positive effect on the company's credit rating score.

H6 Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases if they have a degree, a professional/vocational qualification or have studied/trained in business or management subjects.

3.5 The last three hypotheses relate to agency factors:

H7 Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases if they are not wholly family owned.

H8 Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases if they have external shareholders without access to internal financial information.

H9 Ceteris paribus, the likelihood of the directors choosing a voluntary audit increases if they give a copy of their statutory accounts to the bank and other providers of finance.

Sample Selection and Data Collection

3.6 In March 2003, a list of unlisted, private limited companies that had filed full accounts for 2002 was drawn from FAME⁹ across all industries and regions of Great Britain. As a proxy for qualifying as a small company under EC maxima in force at the time of the study, selection was made on the basis of the company meeting all three of the following criteria in their 2002 accounts:

- turnover not exceeding £4.8m;
- balance sheet total not exceeding £2.4m;
- up to 50 employees.

3.7 This resulted in a list of 3,202 companies that represented the population of companies of this size filing full accounts last year. The list was then screened to remove dormant companies, subsidiaries, groups and holding companies in order to retain only active independent companies, where financial reporting decisions would not be influenced by group policies. Finally, companies that had not provided any named director were eliminated to improve the response rate.

3.8 The questionnaire (see Appendix) was developed and piloted by conducting three interviews with auditors with small company clients and five with directors of small companies. The questionnaire was then reviewed by a number of experienced researchers before being posted to a named director, together with an accompanying letter and prepaid envelope in April 2003. In order to increase the response rate, a reminder was sent in May enclosing another copy of the questionnaire and prepaid envelope, as suggested by Kervin (1992). A further group of companies was eliminated from the initial list because information was received that they had ceased trading, moved away or because the owner was absent/unable to participate. This reduced the list to 2,633 companies. By the cut-off date of 28th May, 790 usable replies had been received, giving a response rate of 30%.

9 A database that contains up to 10 years' information on British companies registered at Companies House one month after the accounts are filed, including more than 2.3m private companies.

3.9 In addition to the survey data, some financial and demographic data was obtained from FAME. Answers to open questions in the questionnaire were categorised thematically, coded and the frequencies recorded. Once all the data had been quantified, it was analysed statistically using SPSS.

Response Rate

3.10 It has already been mentioned that the exact number of companies that qualify as small is not known, as there is no sampling frame that defines companies according to the Companies Act criteria. However, using the category 0 – 50 employees as a proxy, government statistics show that the population of small companies totals 830,990 (SBS, 2002). The size of the sample (790) is sufficient to represent the population, as it greatly exceeds the minimum acceptable sample size of 384 for a population of this size (Krejcie and Morgan, 1970, p. 608).

3.11 Since not all the companies selected responded, a check was made for non-response bias. Previous research suggests that non-respondents behave like late respondents (Morgan, 1974; Wallace and Mellor, 1988). Therefore, a test was conducted to look for corporate size differences between early respondents (those that responded to the first request) and late respondents (those that responded to the second request). Since smaller companies dominate the business population, size is not normally distributed but positively skewed. Therefore, a non-parametric Mann Whitney test was conducted. This compares the number of times a score from one group is ranked higher than a score from the other group. If the two groups are similar, the number of times this happens should also be similar. The results are shown in Table 2.

Table 2 Early and Late Respondents: Mann-Whitney Tests (Non-Parametric Ratio Variables)

Variable	Respondent	N	Mean rank	Sum of ranks	Mann-Whitney U	Wilcoxon W	Z	p
TOVER	1 Early	453	408.95	185253.50	70238.50	127191.50	-1.920	.055
	2 Late	337	377.42	127191.50				
	Total	790						
ASSETS	1 Early	453	406.28	184043.00	71449.00	128402.00	-1.539	.124
	2 Late	337	381.01	128402.00				
	Total	790						
EMPS	1 Early	453	411.59	186450.00	69042.00	125995.00	-2.329	.020
	2 Late	337	373.87	125995.00				
	Total	790						

Notes: TOVER captures turnover (£k)
 ASSETS captures balance sheet total (£k)
 EMPS captures number of employees

3.12 The high value of the probability statistic indicates that there is no significant difference between early and late respondents in terms of turnover and balance sheet total ($p > 0.05$). However, the statistic for the test on number of employees shows that there is a significant difference between the two groups ($p \leq 0.05$). The mean ranks show that late respondents were smaller in terms of number of employees than early respondents. This suggests that non-respondents to the

survey were likely to include companies with fewer or no employees compared to those who participated.¹⁰

- 3.13 An examination of government statistics reveals that 36% of companies have no employees and a further 34% have between 1 and 4 (SBS, 2002, Table 6). Thus, 70% of companies have between 0 and 4 employees and it seems likely that some of these companies would be too busy to participate in surveys and be too small to be interested in developments in the regulatory framework that are not likely to affect them. Indeed, some directors kindly took the trouble to communicate this when declining to participate in the survey.
- 3.14 Nevertheless, the evidence shown in Table 2, together with the satisfactory size of the sample and response rate, allow the findings of the research to be generalised to other unlisted, private limited companies with a turnover up to £4.8m and balance sheet total up to £2.4m filing full accounts with the Registrar of Companies.

¹⁰ Although the mean is not reliable for skewed data such as this, it gives some indication of how large the difference is: the average number of employees for early respondents was 8.79 compared with 7.24 for late respondents.

4 The Sample Companies

Introduction

- 4.1 This chapter provides a profile of the respondents and their views on the value of the statutory audit. It also describes the key characteristics of the sample companies. These attributes range from ownership, management and size to sources of finance, financial reporting, accountancy and agency relationships.

The Directors and their Views on the Audit

- 4.2 The intention of the study was to capture the views of the directors and in 94% of cases the questionnaire was answered by the principal director, finance director or company secretary. The majority of respondents (70%) had a degree, a professional or vocational qualification and/or had studied/trained in business or management subjects. Both the position and this educational profile of the respondents suggest that they would have both tacit and formal knowledge with which to weigh up the costs and benefits of the audit and answer the questionnaire.
- 4.3 In order to examine their perceptions of the potential benefits of the audit, the directors were asked to rate their agreement with various statements regarding the audit on a scale of 1 to 5, where 5 = agree and 1 = disagree (3 = neutral). Table 3 shows the results.

**Table 3 Perceptions of the Audit
(% of Companies)**

Statement	Agree			Disagree			N/A	Total
	5	4	3	2	1			
Provides a check on accounting records and systems	44	21	13	5	5	12	100	
Helps protect against fraud	32	18	16	10	11	13	100	
Improves the quality of the financial information	25	18	20	12	12	13	100	
Improves the credibility of the financial information	38	23	16	5	5	13	100	
Provides assurance to shareholders	26	19	19	10	12	14	100	
Provides assurance to the bank and other lenders	34	24	17	6	6	13	100	
Provides assurance to suppliers and trade creditors	25	20	23	9	9	14	100	
Has a positive effect on the company's credit rating score	26	20	23	8	9	14	100	

Notes: N = 790

More than one response was possible

- 4.4 The main benefits of the audit are that it provides a check on accounting records and systems (65% agree), improves the credibility of the financial information (61% agree) and provides assurance to the bank (58% agree). In addition, 50% of respondents believe that the audit helps protect against fraud and 43% that it improves the quality of the information. There is some justification for the view on

fraud, since the auditor must plan the audit to provide a reasonable expectation of detecting material misstatements (APC, 1990).

Ownership, Management and Size

- 4.5 In terms of ownership, 90% of the sample have between one and four shareholders and 68% are wholly family-owned. In the majority of companies (76%), all shareholders have access to internal financial information, which implies that they are owner-managed; 16% have shareholders without access to such information, which implies that they are 'external' shareholders; and 9% did not respond to the question.
- 4.6 A total of 18% of companies had a professionally qualified company secretary and 31% had a qualified accountant employed in a financial role in the business. In 13% of cases, the qualified accountant was a director.
- 4.7 As is the case with small businesses in general, the majority of the sample companies were at the smaller end of the scale.¹¹ Because of their role in the definition of small in UK law, Tables 4, 5 and 6 analyse the companies by turnover, balance sheet total and number of employees respectively, using data from their 2002 accounts.

Table 4 Size as Measured by Turnover

Turnover	No. of companies	% of companies
Up to £350k	515	65
£351k - £1m	118	15
£1.1m - £4.8m	157	20
Total	790	100

Table 5 Size as Measured by Balance Sheet Total

Balance sheet total	No. of companies	% of companies
Up to £1.4m	703	89
£1.41m – £2.4m	87	11
Total	790	100

Table 6 Size as Measured by Number of Employees

Employees	No. of companies	% of companies
0 – 10	614	78
11 – 20	79	10
21 – 30	47	6
31 – 40	34	4
41 – 50	16	2
Total	790	100

¹¹ As noted in Chapter 3, the sample was not fully representative of companies at the lowest end of the scale.

External Sources of Finance

- 4.8 A total of 349 companies (representing 44% of the sample) indicated that they have external funding in addition to the capital invested by the shareholders and retained profit. Table 7 shows the main sources of finance used by these companies.

Table 7 External Sources of Finance

Source	No. of companies	% of companies
Bank finance	240	69
Personal loans from family or friends	132	38
Hire purchase	111	32
Leasing	69	20
Factoring	31	9
Director's loan	6	2
Venture capital or business angel capital	5	1

Notes: N = 349

More than one response was possible

- 4.9 The main sources of finance are the banks (69% of companies), followed by asset-based finance in the form of hire purchase and leasing (52%). Loans from family, friends and the directors themselves provide funds in 40% of companies.
- 4.10 Further analysis found that in 55% of cases where the company received external funding (apart from directors' loans and personal loans from friends and family), the directors had been required to give a personal guarantee. A significant difference was found between companies that had external finance and those that did not in terms of turnover (Mann-Whitney U 49476; $p < 0.01$), total assets (Mann-Whitney U 48433; $p < 0.01$) and employees (Mann-Whitney U 49034; $p < 0.01$). Thus, the larger the company, the more likely it is to have external funding.
- 4.11 As far as future plans were concerned, only 1% of the 790 companies in the sample plan to obtain a stock exchange listing in the foreseeable future. This suggests that this type of growth strategy is not a major influence on financial reporting decisions.

Financial Reporting and Accountancy

- 4.12 Under little GAAP, qualifying small companies can file either full or abbreviated accounts, but the selection of businesses on the basis of turnover meant that all the companies in the sample had filed full accounts. Most companies with a turnover up to £1m are likely to be eligible for exemption from the audit under UK law as it stands at present, and 80% of the sample fell into this category. The remaining 20% had a turnover above this level but below £4.8m (the EC ceiling at the start of the study).
- 4.13 Although it has already been noted that in 31% of companies a qualified accountant is employed in a financial role in the business, the majority of companies (85%) employ an external accountant to prepare the statutory accounts. Using a maximum turnover of £2.8m as a proxy for eligibility under UK law at the time of the study, it was found that 67% of companies in this size band

had chosen to prepare last year's accounts using the Financial Reporting Standard for Smaller Entities (FRSSE).

- 4.14 Not surprisingly, the accountant was seen as the most important source of information for keeping up to date with financial reporting matters. In 70% of cases this person was the external accountant/auditor and in 29% of cases it was an internal accountant. Table 8 provides details of the range of services provided by the external accountant in addition to the preparation of the statutory accounts.

Table 8 Services Provided by the External Accountant

Service	No. of companies	% of companies
Tax	512	65
Audit	381	48
Additional detailed annual accounts for management's use	283	36
Management advice in connection with the annual results	258	33
Written explanation/analysis of the annual results	215	27
VAT	173	22
Management consultancy	72	9
Advice on raising finance	66	8
Other	78	10

Notes: N = 790

More than one response was possible

- 4.15 As can be seen, tax and audit are the most widely used services, followed by the additional detailed annual accounts for management that are generally included with the statutory accounts prepared for filing in the annual accounting package presented to the directors.
- 4.16 The directors were asked how long the current firm of accountants had been providing audit services and the answers ranged from 1 to 70 years. The mode was 10 years, which suggests that in many companies there is a longstanding relationship with the auditor.¹² Indeed, reference to the value of the relationship with the accountant was made a number of times by directors during the preliminary interviews.
- 4.17 Data relating to the cost of the audit was analysed for all companies that had had an audit of their 2002 accounts. This information is disclosed in the accounts and fees ranged from £114 to £19,000, but the mode was £1,000. Table 9 analyses the audit fee by turnover for the 424 companies (54% of the sample) whose accounts were audited. When interpreting this table, it should be borne in mind that this figure, like many others in the financial statements, could be based on estimation. It was apparent from the preliminary interviews held with auditors that the problem of incomplete accounting records is fairly common in small firms. In such cases, there is considerable overlap in the task of preparing the year-end figures and checking source documents and systems of control, which is part of the auditing function.

¹² This figure is likely to be higher as some respondents wrote '10+' in answer to this question, which was coded as 10 years.

**Table 9 Audit Fees in 2002 by Turnover
(% of Companies)**

Fee	Up to £350k (n = 200)	£351k - £1m (n = 69)	£1.1m - £4.8m (n = 155)
Up to £1,000	46	6	4
£1,001 - £2,000	24	22	10
£2,001 - £3,000	9	20	16
£3,001 - £4,000	8	27	16
£4,001 - £5,000	10	16	15
More than £5,000	3	9	39
Total	100	100	100

Note: N = 424

- 4.18 This analysis suggests that the smaller the company in terms of turnover, the lower the fee. Indeed, further analysis found evidence of significant correlation between turnover and the cost of the audit (Pearson correlation coefficient 0.571; $p < 0.01$)

Agency Relationships

- 4.19 In order to identify potential agency relationships, the respondents were asked who normally receives a copy of the company's statutory accounts. Table 10 gives details of the recipients, apart from shareholders who have a statutory right to receive a copy of the annual accounts.

Table 10 Recipients of the Statutory Accounts

Recipient	No. of companies	% of companies
Inland Revenue	442	56
Bank and other providers of finance	400	51
Directors/managers who are not shareholders	91	11
Major suppliers and trade creditors	68	9
Major customers	50	6
Industry regulators (eg FSA, CAA, ABTA)	30	4
Employees who are not shareholders	17	2

Notes: N = 790

More than one response was possible

- 4.20 The results show that the majority of companies (56%) give their statutory accounts to the Inland Revenue. The proportion may be higher than the reported figure, as this may be dealt with by an external accountant or other tax adviser. Just over half (51%) give their accounts to lenders and nearly 10% give them to creditors. In addition, 13% of companies give a copy of the statutory accounts to directors, managers or other employees who are not shareholders. Major customers receive the accounts in a small proportion of cases and the interview evidence suggests that these would include potential as well as existing customers/clients, as the accounts are often required as part of a tender to supply goods or services. These findings are similar to those found by Collis and Jarvis (2000).

5 Take-Up of Audit Exemption

Introduction

- 5.1 This chapter presents the survey results that relate to the first three research questions:
1. What are the take-up levels of the audit exemption option for companies with a maximum turnover of £1m?
 2. What are the cost savings for companies that have recently discontinued the audit?
 3. What are the likely take-up levels of the audit exemption option if the turnover threshold under UK law is raised to £4.8m?
- 5.2 The analysis examines recent and future decisions in connection with the audit decision and the reasons for the particular choices made.

Audit Decision in 2002

- 5.3 In order to estimate the current take-up of audit exemption, the 2002 accounts were analysed to see whether the company had filed audited accounts or not. Using turnover as a proxy for eligibility, Table 11 shows the responses for the 633 companies in the sample that had a turnover up to the £1m threshold, which came into force in July 2000.

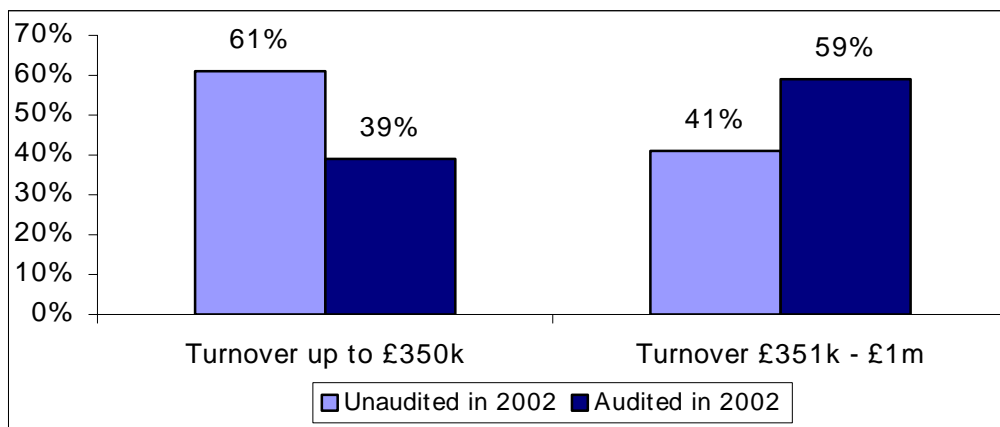
**Table 11 Audit Decision in 2002
(Companies with a Maximum Turnover of £1m)**

Decision	Number of companies	% of companies
Unaudited	364	58
Audited	269	42
Total	633	100

- 5.4 The table shows that the majority of companies (58%) had filed unaudited accounts and further analysis found that these companies had an average turnover of £152k. This can be compared to the 42% that had filed audited accounts, which were found to have a higher average turnover of £269k.¹³
- 5.5 Chart 1 extends the analysis in Table 11 by comparing the audit decision in companies with a turnover up to £350k (the exemption threshold prior to July 2000) with companies with a turnover of between £351k and £1m (the exemption threshold since July 2000).

¹³ Caution must be taken when interpreting these averages, as the sample was not fully representative of the smallest companies and size is positively skewed in the corporate sector.

**Chart 1 Audit Decision in 2002 by Turnover
(Companies with a Maximum Turnover of £1m)**



Notes: Turnover up to £350k N = 515
 Turnover £351k - £1m N = 118
 Total N = 633

5.6 A considerable difference is apparent, with 61% of companies in the smaller size band filing unaudited accounts, compared with 41% in the larger size band. Although this may be attributable to size-related factors, it could be due to other factors such as a time lag between deregulation and the dissemination of information or review of company policy.

Reasons for Filing Unaudited Accounts in 2002

5.7 In order to ascertain the relative importance of cost in the decision to file unaudited accounts last year, the directors were asked to rate various reasons on a scale of 1 to 5, where 5 = important and 1 = not important (3 = neutral). The responses for the 364 companies that had filed unaudited accounts are shown in Table 12.

**Table 12 Reasons for Filing Unaudited Accounts in 2002
(% of Companies with a Maximum Turnover of £1m)**

Reason	Important					No response	Total
	5	4	3	2	1		
Lower accountancy fees	20	5	12	3	11	49	100
On accountant's advice	19	7	10	4	11	49	100
Established company policy	17	6	9	3	12	53	100

Notes: N = 364
 More than one response was possible

5.8 Although aggregation of the data in the above table indicates that lower fees were important to 25% of those choosing to file unaudited accounts, 26% considered this factor unimportant or held neutral views. However, it should be noted that the 'no response' column shows that approximately half of those filing unaudited accounts did not give a reason, despite being given space to write an individual response.

Directors' Views on Exemption from the Statutory Audit

- 5.9 The directors were asked whether overall accountancy costs had decreased if they had recently taken up audit exemption. Only 46 respondents were able to answer this question and their replies are shown in Table 13.

Table 13 Reduction in Accountancy Costs from Discontinuing the Audit

Reduction	No. of companies	% of companies
No reduction	3	6
Up to £1,000	34	75
£1,001 - £2,000	5	11
£2,001 - £3,000	3	6
More than £3,000	1	2
Total	46	100

- 5.10 It can be seen that three companies reported no savings from discontinuing the audit, but the remaining 43 companies made some cost savings. The mode in terms of decreased costs was £1,000.

Reasons for Filing Audited Accounts in 2002

- 5.11 Table 14 examines the reasons for the decision to file audited accounts last year and presents the responses for the 269 companies that did so. In this question the respondents were asked to rate various potential reasons on a scale of 1 to 5, where 5 = important and 1 = not important (3 = neutral).

**Table 14 Reasons for Filing Audited Accounts in 2002
(% of Companies with a Maximum Turnover of £1m)**

Reason	Important		Not important			No response	Total
	5	4	3	2	1		
Wanted to file audited accounts	36	10	8	5	18	23	100
Established company policy	26	12	15	4	13	30	100
Not eligible for exemption	32	4	11	5	21	27	100
On accountant's advice	17	12	13	7	19	32	100
Lower accountancy fees	15	8	20	7	18	32	100

Notes: N = 269

More than one response was possible

- 5.12 The results show that the two main influences on the decision to file audited accounts were the desire to do so (a total of 46% of companies considered this was important) and the continuation of an established company policy (38% of companies considered this was important). A key factor for 36% of companies was that they were not eligible for exemption. These would be companies excluded from the small company qualification on the grounds of size or public interest, as noted in Chapter 1.
- 5.13 The accountant's advice was an importance influence for 29% of companies filing audited accounts. From the opinions collected during the interviews with auditors and directors, the accountant's advice is likely to be particularly valuable when the company's turnover is close to the threshold, when the decision must be reviewed on an annual basis. Interestingly, even though these companies had incurred the cost of having their accounts audited, 23% considered lower accountancy fees were an important factor. This implies that they may be willing

to bear the financial cost of audit as it means lower costs elsewhere; for example, lower borrowing costs. However, as with the previous table, it should be noted that the 'no response' column shows that approximately a quarter to a third of those filing unaudited accounts did not give their views.

- 5.14 The reasons why a company might want to have the accounts audited or why it might be a traditional policy can be explored further by looking at the influence of the users of the financial statements on the audit decision. Table 15 gives details of the users requesting the accounts to be audited for the 424 companies that had filed audited accounts in 2002.

Table 15 Users Requesting the Accounts to be Audited in 2002

User	No. of companies	% of companies
Shareholders	129	30
Bank and other providers of finance	115	27
Inland Revenue	91	21
Major suppliers and trade creditors	14	3
Major customers	12	3

Notes: N = 424

More than one response was possible

- 5.15 It can be seen that the main user groups requiring the accounts to be audited are shareholders, lenders and the Inland Revenue. This extends the findings shown in Table 10, which examined the non-statutory recipients of the statutory accounts, as it includes shareholders, and suggests that the benefit of providing assurance to these parties may offset the cost of the audit.

Appropriate Threshold for Audit Exemption

- 5.16 The letter accompanying the questionnaire gave a summary of the government's proposal to raise the thresholds to the EC levels. Table 16 shows that although 35% of respondents believe that the turnover level should remain at £1m, the majority (57%) support increasing the threshold to £4.8m.

Table 16 Appropriate Turnover Threshold for Audit Exemption

Threshold	No. of companies	% of companies
Increase to £4.8m	451	57
Stay at £1m	278	35
Other	6	1
No response	55	7
Total	790	100

Predicted Audit Decision

- 5.17 In order to estimate the future take-up of audit exemption should the turnover threshold be raised to £4.8m, the directors were asked whether the company's accounts would be audited even if they were not legally required to do so. Despite widespread enthusiasm for lifting the exemption threshold (see Table

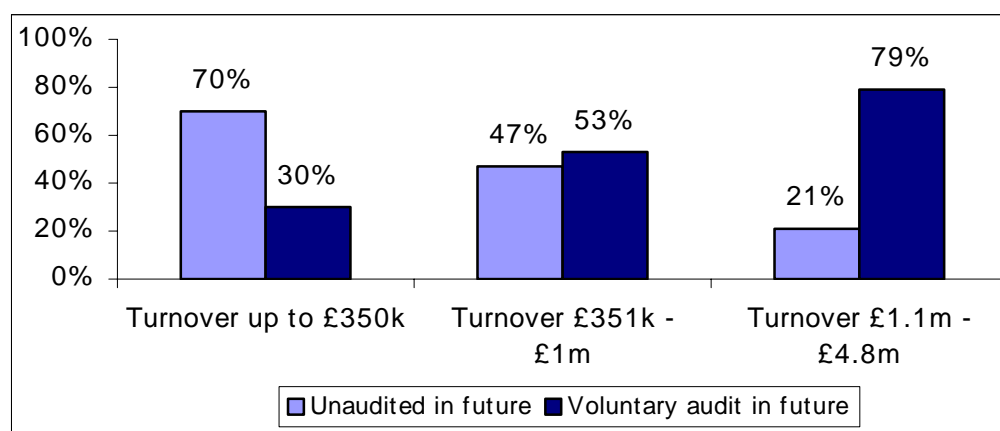
16), which would enable more companies to dispense with the audit, Table 17 shows that 42% of companies would still continue to have their accounts audited.

Table 17 Predicted Audit Decision

Decision	No. of companies	% of companies
Unaudited	438	56
Audited	334	42
No response	18	2
Total	790	100

5.18 Further analysis of this data indicates that the average size of companies that would forgo the audit is £328k, compared with £1.1m for those that would continue to have the accounts audited on a voluntary basis.¹⁴ A total of 772 companies answered this question and Chart 2 extends the above analysis by comparing the audit decision in the companies with a turnover up to £350k (the audit exemption threshold prior to July 200), with those with a turnover between £351k and £1m (the threshold since July 2000) and those with a turnover between £1.1m and £4.8m (the proposed threshold). This provides further evidence of the trend apparent in Chart 1 that the smaller the company in terms of turnover, the more likely it is that the directors will not have the accounts audited.

Chart 2 Predicted Audit Decision by Turnover

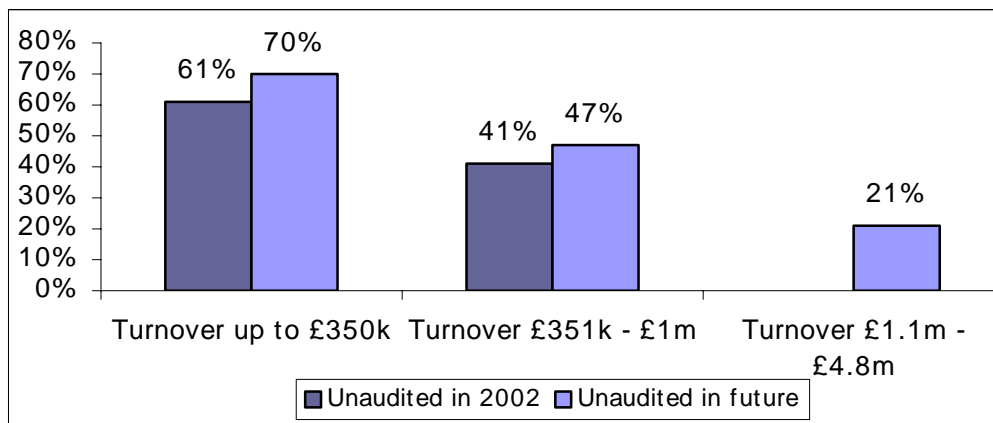


Notes: Turnover up to £350k N = 506
 Turnover £351k - £1m N = 114
 Turnover £1.1m - £4.8m N = 152
 Total N = 772

5.19 Chart 3 compares the actual levels of take-up of audit exemption in 2002 (Chart 1) with the directors' predictions of their decision if they were to become exempt in future (Chart 2).

¹⁴ As already mentioned, caution must be taken when interpreting averages based on company size.

Chart 3 Comparison of Actual and Predicted Audit Decisions by Turnover



Notes: Unaudited in 2002 N = 364 (companies with turnover up to £1m)
 Unaudited in future N = 438 (companies with turnover up to £4.8m)

5.20 The above comparison of actual practice and predicted practice suggests that take-up rates could be higher in future. However, it may be that part of the differences illustrated in the chart are due to a desire to be relieved of the obligation of the audit by companies that are excluded from exemption on the grounds of public interest. Indeed, a number of directors with statutory obligations to bodies such as the Financial Services Authority (FSA) or the Association of British Travel Agents (ABTA) expressed this wish when responding to open questions at various points in the questionnaire.

Reasons for Predicted Audit Decision

5.21 In order to identify the main reasons for the audit decision if the company were not legally required to have the accounts audited, the directors were invited to respond in their own words, rather than prompting them with a list of suggested answers.

5.22 Of the 438 companies that stated that they would discontinue the audit, 219 gave answers. Table 18 shows the results of categorising these answers and reveals that the main reasons for dispensing with the audit relate to lack of need and potential cost savings.

Table 18 Reasons for not having a Voluntary Audit

Reason	No. of companies	% of companies
No benefit/not necessary	96	44
Cost savings	92	42
Other	31	14
Total	219	100

5.23 Of the 334 companies that indicated that they would have a voluntary audit if they became exempt, 136 provided reasons. Table 19 presents the results of categorising these answers and shows that the main reason for wanting a voluntary audit is the independent check and the associated assurance this provides to third parties.

Table 19 Reasons for having a Voluntary Audit

Reason	No. of companies	% of companies
Check/assurance for third parties	95	70
Good practice/governance	19	14
Other	21	16
Total	136	100

- 5.24 The reasons shown in Tables 18 and 19 for the audit decision provide further evidence of the directors' need to balance the cost of the audit against the benefits. Table 19 identifies the main benefit of having the accounts audited in connection with agency relationships, and a secondary benefit that relates to good management.

6 Factors that Influence the Voluntary Audit Decision

Introduction

- 6.1 In Chapter 5 it was revealed that the directors were divided on the question of whether they would have the accounts audited if the company were not legally required to do so (see Table 17). Based on their predictions of future behaviour, 56% would not have the accounts audited and 42% would choose to have a voluntary audit (2% did not respond). This chapter examines the characteristics of these two subgroups in the sample and addresses the fourth research question:
4. What are the factors that have a significant influence on the demand for the audit among companies with a maximum turnover of £4.8m?
- 6.2 The analysis draws on some of the key findings reported in the previous two chapters and tests the nine hypotheses set out in Chapter 3. For convenience, these are reproduced below:
- H1 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit increases with size, as measured by turnover.
 - H2 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit increases with perceptions that the audit provides a check on accounting records and systems.
 - H3 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit increases with perceptions that the audit improves the quality of the financial information.
 - H4 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit increases with perceptions that the audit improves the credibility of the financial information.
 - H5 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit increases with perceptions that the audit has a positive effect on the company's credit rating score.
 - H6 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit increases if they have a degree, a professional/vocational qualification or have studied/trained in business or management subjects.
 - H7 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit increases if they are not wholly family owned.
 - H8 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit increases if they have shareholders without access to internal financial information.
 - H9 *ceteris paribus*, the likelihood of the directors choosing a voluntary audit does not increase if they have give a copy of their statutory accounts to the bank and other providers of finance.
- 6.3 These theoretical propositions are tested using logistic regression, which is a technique for predicting an outcome (the dependent variable) from a number of

predictor variables (the independent variables) using multiple regression. The logistic regression is preceded by tests to establish the independence of these two groups in relation to each predictor variable.

Variables in the Analysis

6.4 Table 20 summarises the variables in the analysis.

Table 20 Demand for a Voluntary Audit: Variables in the Analysis

Variable	Description	Expected sign	Hypothesis tested
VOLAUDIT	Whether the company would have a voluntary audit	Dependent variable	
TOVER	Turnover in 2002 accounts	Positive	H1
CHECK	Extent of agreement that the audit provides a check on accounting records and systems	Positive	H2
QUALITY	Extent of agreement that the audit improves the quality of the financial information	Positive	H3
CREDIBLY	Extent of agreement that the audit improves the credibility of the financial information	Positive	H4
CREDITSC	Extent of agreement that the audit has a positive effect on the company's credit rating score	Positive	H5
EDUCATN	Whether the respondent has a degree, professional/vocational qualification or has studied or trained in business/management subjects	Positive	H6
FAMILY	Whether the company is wholly family-owned	Negative	H7
EXOWNERS	Whether the company has shareholders without access to internal financial information	Positive	H8
BANK	Whether the statutory accounts are given to the bank and other providers of finance	Positive	H9

- 6.5 VOLAUDIT is the dependent variable in the analysis and consists of two groups (Question 14 in the questionnaire). The first group contains companies where the directors would have the accounts audited on a voluntary basis even if the company was not legally required to do so. These companies are coded 1. The second group contains companies where the directors would not have the accounts audited if the company were free to choose. These companies are coded 0. Non-responses are excluded.
- 6.6 TOVER represents size factors in the analysis and captures turnover, the key measure used in UK law for audit exemption. It is expected to have a positive influence on the dependent variable and is used to test H1. The data for this variable was obtained in £k from the 2002 accounts on FAME. The data for all the other variables is taken from the questionnaire survey.
- 6.7 CHECK, QUALITY, CREDIBLY and CREDITSC represent management factors. They capture whether the directors perceive the audit as providing a check on accounting records and systems, improving the quality or the credibility of the financial information and having a positive effect on the company's credit rating score respectively (Questions 15a, 15c, 15d and 15h in the questionnaire). These latent variables are used to test H2 – H5 and are expected to be positively associated with the dependent variable. They are coded on a scale of 1 to 5, where 5 = agree and 1 = disagree with the statement. Non-responses are excluded.
- 6.8 EDUCATN also represents management factors and is a proxy for the directors' knowledge of the costs and benefits of the audit. It is a dummy variable used to

test H6 and is expected to have a positive influence on the dependent variable. It is coded 1 if the respondent has a degree, professional/vocational qualification or has studied or trained in business/management subjects, and 0 if not (Question 23 in the questionnaire).

- 6.9 FAMILY represents agency relationships with shareholders and captures whether the company is wholly family-owned (Question 1 in the questionnaire). It is used to test H7 and is expected to be negatively associated with the dependent variable. It is a dummy variable that is coded 1 if the company is wholly family-owned and 0 if not. Non-responses are excluded.
- 6.10 EXOWNERS also represent agency relationships with shareholders and captures whether there are external shareholders (Question 3 in the questionnaire). It is a dummy variable that is used to test H8 and is expected to have a positive influence on the dependent variable. It is coded 1 if there are shareholders without access to internal financial information and 0 if not. Non-responses are excluded.
- 6.11 BANK represents agency relationships with lenders and captures whether the statutory accounts are given to the bank and other providers of finance (Question 18 in the questionnaire). It is a dummy variable that is used to test H9 and is expected to have a positive influence on the dependent variable. It is coded 1 if the company gives the statutory accounts to the bank and other providers of finance and 0 if not.
- 6.12 Table 21 categorises the variables in the analysis by type of data, coding, number of companies providing data (N) and descriptive statistics as appropriate.¹⁵

¹⁵ Strictly speaking, the mean cannot be calculated for ordinal data, since the numeric scale represents ranked nominal categories. It is given here as an indication rather than a measure of central tendency. The multivariate statistics were based on ranked data.

Table 21 Demand for a Voluntary Audit: Descriptive Statistics

Variable	Data	Coding	N	Min	Max	Mean	SD
VOLAUDIT	Nominal	(1 = yes, 0 = no)	772	0	1	N/A	N/A
TOVER	Ratio	(£k)	790	.05	4738.27	691.07	1119.45
CHECK	Ordinal	(5 = agree, 1 = disagree)	697	1	5	4.05	1.19
QUALITY	Ordinal	(5 = agree, 1 = disagree)	687	1	5	3.35	1.38
CREDIBLY	Ordinal	(5 = agree, 1 = disagree)	688	1	5	3.95	1.18
CREDITSC	Ordinal	(5 = agree, 1 = disagree)	681	1	5	3.55	1.29
EDUCATN	Nominal	(1 = yes, 0 = no)	790	0	1	N/A	N/A
FAMILY	Nominal	(1 = yes, 0 = no)	785	0	1	N/A	N/A
EXOWNERS	Nominal	(1 = yes, 0 = no)	722	0	1	N/A	N/A
BANK	Nominal	(1 = yes, 0 = no)	790	0	1	N/A	N/A

Preliminary Tests

- 6.13 To establish the independence of the two groups in the dependent variable (VOLAUDIT) and each independent variable measured on a non-parametric ratio scale (TOVER) or ordinal scale (CHECK, QUALITY, CREDIBLY, CREDITSC), Mann-Whitney tests of difference were conducted. Table 22 shows the results.

Table 22 Demand for a Voluntary Audit: Mann-Whitney Tests (Non-Parametric Ratio and Ordinal Variables)

Variable	VOLAUDIT	N	Mean rank	Sum of ranks	Mann-Whitney U	Wilcoxon W	Z	p
TOVER	0 No	438	311.29	136344.50	40203.50	136344.50	-10.731	.000
	1 Yes	334	485.13	162033.50				
	Total	772						
CHECK	0 No	362	285.45	103332.00	37629.00	103332.00	-8.519	.000
	1 Yes	320	404.91	129571.00				
	Total	682						
QUALITY	0 No	356	268.62	95629.00	32083.00	95629.00	-9.864	.000
	1 Yes	316	412.97	130499.00				
	Total	672						
CREDIBLY	0 No	358	278.17	99584.00	35323.00	99584.00	-8.851	.000
	1 Yes	315	403.86	127217.00				
	Total	673						
CREDITSC	0 No	355	273.52	97100.00	33910.00	97100.00	-8.928	.000
	1 Yes	312	402.81	125678.00				
	Total	667						

- 6.14 The low values of the probability statistics in the above table provide evidence of a significant difference between the two groups in each test ($p \leq 0.05$) and therefore these independent variables are included in the regression model.
- 6.15 Chi-square tests were used to measure the association between the two groups in the dependent variable (VOLAUDIT) and each of the independent variables measured on a dichotomous nominal scale (FAMILY, EXOWNERS, BANK, EDUCATN). Table 23 presents the results.

Table 23 Demand for a Voluntary Audit: Chi-Square Tests (Nominal Variables)

Variable		VOLAUDIT		N	Chi-square	df	p
		0 No	1 Yes				
FAMILY	0 No	102	144	246	33.103	1	.000
	1 Yes	331	190	521			
	Total	433	334	767			
EXOWNERS	0 No	351	235	586	17.406	1	.000
	1 Yes	47	73	120			
	Total	398	308	706			
BANK	0 No	264	116	380	49.468	1	.000
	1 Yes	174	218	392			
	Total	438	334	772			
EDUCATN	0 No	124	105	229	.888	1	.346
	1 Yes	314	229	543			
	Total	438	334	772			

- 6.16 The probability statistics in Table 23 provide evidence of a significant positive association between the two groups in the dependent variable (VOLAUDIT) and the two categories in the independent variables FAMILY, EXOWNERS and BANK ($p \leq 0.05$). Therefore, these three variables can also be included in the regression model. However, the result for EDUCATN is non-significant ($p > 0.05$). This provides evidence to reject H6, as there is no significant difference between the audit decision and the educational profile of the directors.

Logistic Regression Model

- 6.17 The logistic regression model tests the remaining hypotheses H1 – H5 and H7 – H9. Table 24 presents the results.

Table 24 Demand for a Voluntary Audit: Logistic Regression

Variable	B	SE	Wald	df	p	Exp(B)
TOVER	.001	.000	22.970	1	.000	1.001
CHECK	.258	.122	4.437	1	.035	1.294
QUALITY	.393	.103	14.664	1	.000	1.482
CREDIBLY	.137	.127	1.170	1	.279	1.147
CREDITSC	.245	.096	6.486	1	.011	1.277
FAMILY	-.789	.212	13.777	1	.000	.455
EXOWNERS	.660	.268	6.084	1	.014	1.935
BANK	.445	.216	4.235	1	.040	1.560
Constant	-4.176	.550	57.758	1	.000	.015

Notes: N = 599

Model summary: Chi-square 209.874; df 8; $p < 0.01$; -2 log likelihood 618.912; pseudo R^2 .394

- 6.18 The table shows that the probability statistic for CREDIBLY is non-significant ($p > 0.05$). This provides evidence to reject H4, as it means the audit decision is not significantly influenced by the view that the audit improves the credibility of the financial information. However, results for TOVER, CHECK, QUALITY, CREDITSC, FAMILY, EXOWNERS and BANK are significant ($p \leq 0.05$). Moreover, the factor coefficient (B) for FAMILY indicates the expected negative relationship with the demand for a voluntary audit. Therefore, there is evidence to accept H1 – H3, H5 and H7 – H9.

- 6.19 Thus, the model reveals that the directors are more likely to have a voluntary audit if the company has the following characteristics:
- It is larger in terms of turnover and the directors consider the audit improves the quality of the financial information, has a positive effect on the credit rating score and provides a check on accounting records and systems; and
 - it is not wholly family-owned (ie there are non-family shareholders) and has shareholders without access to internal financial information; and
 - the directors normally give a copy of the statutory accounts to the bank and other providers of finance.
- 6.20 The pseudo R^2 shown in the notes to the table indicates that the independent variables in the regression model explain 39% of the demand for the audit. The higher values of the Wald statistic and the lower values of the probability statistic for TOVER, QUALITY and FAMILY compared with the other variables indicates that turnover, perceptions that the audit improves the quality of the information and the existence of non-family shareholders are the most influential.

7 Discussion and Conclusions

Contribution of the Study

- 7.1 The question of the size of company that should be eligible for exemption from the statutory audit is an important aspect of the big GAAP/little GAAP debate in the UK. This study was commissioned by the DTI in February 2003 and contributes to that debate by analysing the views and practices of the directors of private limited companies with a turnover up to £4.8m (the EU threshold at the time of the study). It is appropriate that the DTI has supported this survey of the directors of small companies, since they are the main users of the accounts and bear the cost of the statutory audit. In addition, it supports the government's stance on evidence-based policy making (Cabinet Office, 1999).
- 7.2 The rationale for focusing on companies of this size study is the proposal that the audit exemption thresholds in the UK should be raised to EC levels (DTI, 2000). This has resulted in some controversy. However, to a great extent, the discussion has been dominated by the regulators and the accountancy profession, whilst the views of the main users of the audited accounts, the directors of the small companies concerned, have been ignored. Moreover, until recently there has been little up-to-date empirical evidence on issues relating to the small company audit and consequently the debate has been largely based on anecdotal evidence.
- 7.3 The study is based on the analysis of 790 postal questionnaires received from a population of 2,633 active, independent, unlisted, private limited companies filing full accounts. This represents a response rate of 30%. The companies were selected on the basis of their 2002 accounts providing figures that showed that they had a maximum turnover of £4.8m, maximum balance sheet total of £2.4m and up to 50 employees. These selection criteria were used as a proxy for qualification as a small company under EC law and were the EC maxima thresholds as they stood in April 2003. Since the study commenced, the EC thresholds have been increased as part of the five-yearly review of economic and monetary trends in the EC.
- 7.4 The selection of companies on the basis of turnover was essential, as this is the key measure of size for audit exemption in the UK. However, it means that the sample consisted of companies filing full accounts and one limitation of the study is that companies filing abbreviated accounts were not consulted.

Generalisability

- 7.5 Tests for non-response bias in terms of size were non-significant for turnover and balance sheet total, which means that the sample was representative of the main body of similar sized companies by these measures. However, it was found that non-respondents were likely to be smaller in terms of number of employees. Nevertheless, the sample of 790 companies is sufficient to represent the

population, as it greatly exceeds the minimum acceptable sample size of 384. This, together with the satisfactory response rate of 30%, allows the findings of the research to be generalised to other unlisted, private limited companies with a turnover up to £4.8m and balance sheet total up to £2.4m filing full accounts with the Registrar of Companies.

The Sample Companies

- 7.6 In 94% of cases the questionnaire was answered by the principal director, finance director or company secretary. The position and educational profile of the respondents suggested they would have both tacit and formal knowledge with which to answer the questions and weigh up the costs and benefits of the audit when making the audit decision. As in the wider population, the majority of the sample companies were at the smaller end of the scale in terms of ownership and size: 90% have between one and four shareholders and 68% are wholly family-owned. In 74% of companies, all the shareholders have access to internal financial information, which implies that the majority are owner-managed. In terms of size, 80% had a maximum turnover of £1m in their 2002 accounts, 89% had a maximum balance sheet total of £1.4m and 78% had between 0 and 10 employees.
- 7.7 A large proportion of companies (44%) have external funding in addition to the capital invested by the shareholders and retained profit. The main source of finance is from the bank (69%) and 52% use asset-based finance (hire purchase and leasing). This corroborates previous research (Cosh and Hughes, 2000; Bank of England, 2003) that banks are the main source of finance to small firms. However, the present study highlights the importance of personal loans from family or friends and these sources of finance are used in 38% of companies. Tests found that the larger the company, the more likely it is to have external funding and this confirms previous research that larger firms are more likely to seek external finance than smaller firms (Cosh and Hughes, 2003). In 55% of cases where the company has external funding, the directors had been required to give a personal guarantee. Only 1% of the sample companies plan to obtain a stock exchange listing in the foreseeable future, which suggests that this is not a major influence on financial reporting decisions.
- 7.8 Although 31% employ a qualified accountant in a financial role in the business, it would appear that accounts preparation is usually outsourced, as in 85% of companies an external accountant prepares the statutory accounts. This is consistent with previous studies (Collis and Jarvis, 2000; Carsberg et al., 1985). Using a maximum turnover of £2.8m as a proxy for eligibility, 67% of respondents reported that their 2002 accounts had been prepared using the FRSSE. This provides important evidence on the take-up of this particular aspect of little GAAP.
- 7.9 In a significant proportion of companies the external accountant also provides tax services (65%), audit services (48%), additional accounts (36%) and/or advice in connection with the annual results (33%). There was evidence of a long relationship with the external accountant. Ten years was the typical length of time with the current auditor and £1,000 the typical audit fee disclosed in the 2002 accounts. These findings confirm previous research, which identifies external accountants as the main source of advice to small firms (Bennett and

Robson, 1998) and suggests that the majority of entrepreneurial businesses are satisfied with the advice they receive from their accountants with regard to accounts preparation and the audit (Haythornthwaite, 2003).

- 7.10 The majority of companies give a copy of their statutory accounts to the Inland Revenue (56%) and just over half give them to the bank and other providers of finance (51%). The proportion of those providing statutory accounts to support tax computations may be higher than the reported figure, as this may be dealt with by the accountant or other tax adviser.

Take-Up of Audit Exemption

- 7.11 Using a maximum turnover of £1m as a proxy for eligibility, 58% of the sample took up audit exemption in their 2002 accounts compared with 42% who filed audited accounts.
- 7.12 The main reason for filing unaudited accounts in 2002 was lower accountancy fees, but very few directors were able to report the specific amount saved. Of those that did provide a figure, the typical reduction was £1,000. This seems valid, as it matches the typical fee disclosed in the 2002 accounts. The fact that so few directors reported any savings from discontinuing the audit implies that it may not have been a significant saving or that it was offset by other charges. The latter is a logical explanation, as it was apparent from the preliminary interviews with accountants that there is often considerable overlap between time spent on accounts preparation and time spent on auditing the accounts. A further explanation is suggested by previous research, which found that approximately a third of entrepreneurial firms admit to 'never understanding their accountants' fees' (Haythornthwaite, 2003, p. 60).
- 7.13 The main reasons for filing audited accounts in 2002 were the desire to do so (46% of the sample companies) and the continuation of company policy (38%). The main users requesting the accounts to be audited in 2002 were shareholders (30%) and the bank and other providers of finance (27%).
- 7.14 The proposal to raise the audit exemption threshold to a maximum turnover of £4.8m is supported by 57% of companies, whilst 35% believe that it should remain at £1m. If the requirement for a statutory audit is removed, 42% predict that they would have the company's accounts audited on a voluntary basis compared with 56% who would not (2% did not respond). Among companies that would be eligible for exemption for the first time (ie those with a turnover above £1m), the majority (79%) see sufficient benefits in having their accounts audited that they would choose to have a voluntary audit.
- 7.15 The main reasons given by those who predicted that they would opt for exemption from the audit if eligible were that there would be no benefit in having the accounts audited (44% of those responding) or that there would be cost savings from discontinuing the audit (42%).
- 7.16 The main reason given by those who predicted that they would have a voluntary audit was that it provides a check/assurance for third parties (70% of those responding). These findings confirm previous research (Collis et al., 2003b), which shows that companies fall into two distinct groups with differing needs.

Influences on the Voluntary Audit Decision

- 7.17 The results of further analysis of the factors that have a significant influence on the audit decision using logistic regression reveal the directors are more likely to have a voluntary audit if the company has the following characteristics: It is larger in terms of turnover and the directors consider that the audit improves the quality of the financial information, has a positive effect on the credit rating score and provides a check on accounting records and systems; and it is not wholly family-owned (ie there are non-family shareholders) and has shareholders without access to internal financial information; and the directors normally give a copy of the statutory accounts to the bank and other providers of finance.
- 7.18 Turnover represents the cost burden in the model. Thus, the larger the turnover, the lower the relative cost. To some extent, it can be argued that turnover also captures whether the company is large enough to have external or non-family shareholders and external borrowings. However, these factors are better explained by the theory that the directors will be willing to bear the cost of the audit because of their beliefs about the benefits of the audit and the role the audited accounts play in reducing the cost of capital and supporting agency relationships (with shareholders and lenders) where there is information asymmetry.
- 7.19 These findings extend previous work by the author (Collis and Jarvis, 2000; Collis et al., 2001b; Collis, 2003) which examined the views of the directors of slightly smaller companies (maximum turnover £4.2m) in 1999. Two additional influences on the audit decision are identified by the present study. These relate to beliefs about the beneficial effect of the audit on the company's credit rating score and its role in providing assurance to shareholders without access to internal financial information.

Implications of the Findings

- 7.20 The findings of this study can be generalised to other active, independent, private limited companies filling full accounts with a maximum turnover of £4.8m and balance sheet total up to £2.4m. They should be of interest to the regulators, the accountancy profession, those who advise small companies and academics, as well as the owners and directors of small companies themselves.
- 7.21 If the higher EC maxima are adopted for defining a small company in the UK, most companies of a similar size to those in this study will be free to choose whether or not to have the accounts audited. Among those that would be eligible to choose for the first time, it seems likely that the vast majority (79% is the proportion suggested by this study) will choose a voluntary audit since the benefits outweigh the costs. This will be reassuring to small practitioners who rely on audit fee income from small company clients. It will also be reassuring to banks, lenders and other providers of credit who rely on the audited financial statements for assessing risk. However, these parties have the economic power to ensure that their needs are met and it is important that future regulation continues to protect the needs of the shareholders requiring the additional assurance of an external audit.

- 7.22 The findings of this study provide evidence that size is not a sufficient measure on its own for capturing the costs and benefits of the audit. There are other qualitative factors. If thresholds are raised to EC levels, policy makers should be aware that the new category of small companies would contain two subgroups with differing needs. This is demonstrated by the significant proportion of directors whose audit decisions indicate that the benefits outweigh the costs. This heterogeneity should also be taken into account by those who contribute to the development of differential reporting on the basis of size at the international level.

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Appendix

No.



Survey of Company Directors' Views on the Statutory Audit

Commissioned by



April 2003

Directors' Views on Exemption from the Statutory Audit

Your participation in this research is greatly appreciated.
Neither your name, nor that of your company will be associated with any of your responses.

1. Is the company a family-owned business? (Tick one box only)

- | | | |
|--------------------------------------|--------------------------|-----|
| Wholly family-owned | <input type="checkbox"/> | (1) |
| Partly family-owned | <input type="checkbox"/> | (2) |
| None of the shareholders are related | <input type="checkbox"/> | (0) |

2. Does the company have a professionally qualified company secretary? (Tick one box only)

- | | | |
|-----|--------------------------|-----|
| Yes | <input type="checkbox"/> | (1) |
| No | <input type="checkbox"/> | (0) |

3. How many shareholders (owners) does the company have?

- | | | |
|--|----------------------|--|
| (a) Total number of shareholders | <input type="text"/> | |
| <i>Breakdown:</i> | | |
| (b) Number of shareholders with access to internal financial information | <input type="text"/> | |
| (c) Number of shareholders <u>without</u> access to internal financial information | <input type="text"/> | |

4. How many qualified accountants are employed in financial roles in the company?

- | | | |
|---|----------------------|--|
| (a) Total number of qualified accountants | <input type="text"/> | |
| <i>Breakdown:</i> | | |
| (b) Number of qualified accountants who are also directors | <input type="text"/> | |
| (c) Number of qualified accountants in the company who are <u>not</u> directors | <input type="text"/> | |

5. Does the company employ an external accountant to prepare the statutory accounts for filing at Companies House? (Tick one box only)

- | | | |
|-----|--------------------------|-----|
| Yes | <input type="checkbox"/> | (1) |
| No | <input type="checkbox"/> | (0) |
- (Go to question 7)

6. Which of the following services does the external accountant provide?

(Tick as many boxes as apply)

- | | | |
|--|--------------------------|--|
| (a) Additional detailed annual accounts for management's use | <input type="checkbox"/> | |
| (b) Written explanation/analysis of the annual results | <input type="checkbox"/> | |
| (c) Management advice in connection with the annual results | <input type="checkbox"/> | |
| (d) Audit | <input type="checkbox"/> | |
| (e) Tax | <input type="checkbox"/> | |
| (f) VAT | <input type="checkbox"/> | |
| (g) Management consultancy | <input type="checkbox"/> | |
| (h) IT consultancy | <input type="checkbox"/> | |
| (i) Investment advice | <input type="checkbox"/> | |
| (j) Advice on raising finance | <input type="checkbox"/> | |
| Other (<i>please state</i>) | <input type="text"/> | |

7. Were last year's statutory annual accounts prepared using the Financial Reporting Standard for Smaller Entities?

(This is shown in the accounts)

- | | | |
|-----|--------------------------|-----|
| Yes | <input type="checkbox"/> | (1) |
| No | <input type="checkbox"/> | (0) |

Directors' Views on Exemption from the Statutory Audit

8. Were last year's statutory annual accounts audited?

(This is shown in the accounts)

Yes (1)
 No (0) (Go to question 11)

9. How long have the current auditors been providing this service?

Number of years

10. If last year's statutory accounts were audited, what was the cost of the audit?

(This is shown as a note in the accounts)

Last year's audit fees £
 (Go to question 12)

11. If the statutory accounts were not audited last year but were audited previously, have overall accountancy costs decreased?

No (0)
 Yes, by approximately £

12. How important were the following factors in the audit decision last year?

(Circle the number closest to your view)

	Important			Not important	
	5	4	3	2	1
(a) Wanted to file audited accounts	5	4	3	2	1
(c) Not eligible for exemption from the statutory audit	5	4	3	2	1
(d) Lower accountancy fees	5	4	3	2	1
(e) Following advice from the accountant	5	4	3	2	1
(f) Following established company policy	5	4	3	2	1
Other (please state)					

13. Do you think the turnover threshold for exemption from the statutory audit should be increased from £1m to £4.8m?

(Tick one box only)

Yes, increase to £4.8m (1)
 No, stay at £1m (0)
 Other (0) £m

14. Would you have the accounts audited even if the company were not legally required to do so?

(Tick one box only)

Yes, the accounts are already audited voluntarily (1)
 Yes, the accounts would be audited voluntarily (2)
 No (0)

Please give reasons for either answer

.....

15. What are your views on the following statements regarding the audit?

(Circle the number closest to your view)

	Agree			Disagree	
(a) Provides a check on accounting records and systems	5	4	3	2	1
(b) Helps protect against fraud	5	4	3	2	1
(c) Improves the quality of the financial information	5	4	3	2	1
(d) Improves the credibility of the financial information	5	4	3	2	1
(e) Provides assurance to shareholders	5	4	3	2	1
(f) Provides assurance to the bank and other lenders	5	4	3	2	1
(g) Provides assurance to suppliers and trade creditors	5	4	3	2	1
(h) Has a positive effect on company's credit rating score	5	4	3	2	1
Other <i>(please state)</i>					

.....

16. How important are the following sources of information for keeping up to date with matters relating to the statutory annual accounts and the audit?

(Circle the number closest to your view)

	Important			Not important	
(a) External accountant/auditor	5	4	3	2	1
(b) Internal accountant	5	4	3	2	1
(c) Company secretary	5	4	3	2	1
(d) Newspapers, journals and other publications	5	4	3	2	1
(e) The Internet	5	4	3	2	1
(f) Other business owners	5	4	3	2	1
Other <i>(please state)</i>					

.....

17. Do you plan to obtain a stock exchange listing for the company in the foreseeable future?

(Tick one box only)

Yes	<input type="checkbox"/>	(1)
No	<input type="checkbox"/>	(0)

18. Apart from Companies House, who normally receives a copy of the company's statutory accounts?

(Tick as many boxes as apply)

(a) Shareholders	<input type="checkbox"/>	
(b) Bank and other providers of finance	<input type="checkbox"/>	
(c) Directors/managers who are <u>not</u> shareholders	<input type="checkbox"/>	
(d) Employees who are <u>not</u> shareholders	<input type="checkbox"/>	
(e) Major suppliers and trade creditors	<input type="checkbox"/>	
(f) Major customers	<input type="checkbox"/>	
(g) Inland Revenue	<input type="checkbox"/>	
Other <i>(please state)</i>	<input type="checkbox"/>	

.....

Directors' Views on Exemption from the Statutory Audit

19. If the accounts were audited last year, is it because any of the following users requested it?

(Tick as many boxes as apply)

- (a) Shareholders
- (b) Bank and other providers of finance
- (c) Major suppliers and trade creditors
- (d) Major customers
- (e) Inland Revenue
- Other *(please state)*

.....

20. Apart from capital invested by the shareholders and retained profit, is the company currently financed by any of the following?

(Tick as many boxes as apply)

- (a) Personal loans from family or friends.
- (b) Bank finance
- (c) Business angel capital
- (d) Venture capital
- (e) Leasing
- (f) Hire purchase
- (g) Factoring
- Other *(please state)*

.....

21. Have the directors been required to give a personal guarantee in order to obtain finance for the company?

(Tick one box only)

- Yes
- No

	(1)
	(0)

22. What is your position in the company?

(Tick one box only)

- The sole director
- The principal director (eg managing director or chief executive)
- The finance director
- Other *(please state)*

	(1)
	(2)
	(3)

.....

23. Do you have any of the following qualifications/training?

(Tick as many boxes as apply)

- (a) Undergraduate or postgraduate degree
- (b) Professional/vocational qualification
- (c) Study/training in business or management subjects

24. Would you like a summary of the findings? If so, please print your details or attach your business card.

Name

Email

Mailing address (if preferred)

.....

.....

25. Would you like to receive a copy of the DTI's consultation document so that you can give your views on the audit threshold directly? If so, please contact:

Bill Murphy
DTI Company Law and Investigations Directorate
V 4100
1 Victoria Street
London SW1H 0ET

Tel: 020 7215 0412
Fax: 020 7215 0235
Email: william.murphy@dti.gsi.gov.uk

*Thank you very much for taking part in this survey
Please return your completed questionnaire in prepaid envelope
as soon as possible*

Jill Collis
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