To audit or not to audit?
- How is auditing being used in banks’ credit rating processes?
Abstract

Credit rating systems are complex processes and involve mainly two parties; a company and a bank. The complexity of a relationship between a company and a bank lies in the fact that a company usually has access to more information about the company than the bank. Hence, an auditor acts as a third party who validates the information involved in credit rating processes. The purpose of this dissertation is to explore how auditing is being used in credit rating processes and to identify the role auditing has. In addition, this study recognizes the use of auditing in both Denmark and Sweden, with a goal to compare and explore the differences between the countries.

In order to collect secondary data, Danish and Swedish banks were interviewed. To be able to explore the rather newly discovered relationship between auditing and credit rating processes, this study was carried out with an exploratory research design. In addition, this study is based on assumptions stated in the Agency Theory, the Positive Accounting Theory and the Stakeholder Model. Because the intention was to use existing theories, a deductive research approach was suitable.

The empirical findings imply that auditing is being used in banks’ credit rating processes to validate the information and to reduce the risk. The trustworthiness of auditors and the relationship between a company and a bank influence banks’ perceptions regarding the creditworthiness of companies. The role of auditing is rather common in Denmark and Sweden, whereas the amount of accessible information is higher in Sweden than in Denmark. The pattern is that more information diminishes the risk and implies that the role of auditing is less important.

This study is limited to only taking the bank’s perceptions of auditing into consideration, leaving out other stakeholders. Moreover, the examination is restricted to Danish and Swedish banks. The findings are interesting for banks and small companies to consider, because they explain the importance of auditing other components such as customer relationship. As a conclusion, the findings would be appropriate for Swedish banks to review in order to evaluate possible consequences of the statutory audit.

Keywords: Credit rating processes, Denmark, Sweden, auditing, information, risk, trust relationship.
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Aida Ademi                               Ammeli Stigborn
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1. Introduction

This chapter includes a discussion about the background, problem purpose, research question and theoretical limitations. The aim of this chapter is to provide an insight in the framework and background of our investigation.

1.1 Background

Nowadays there are a lot of transactions between different people and/or companies and you put yourself in a vulnerable position when signing an agreement. You depend on the other partner to fulfill their end of the contract. To make sure that the level of trust is mutual on both sides and that the level of risk is low, you take all kinds of precautions.

These circumstances can, for example, occur in a credit lending situation, where the bank signs an agreement with a company about the terms and conditions of a loan. In this situation there may be asymmetric information, where the management may have more knowledge about the financials of the company than the bank. There are various theories about this situation and perhaps the best known is the Agency Theory.

The Agency Theory with its asymmetric information explains the relationship between a principal and an agent (Hsien-Hsing, 2009; Jensen & Meckling, 1976). This theory is concerned with resolving two problems that can occur in agency relationships:

1. The problem that arises when the desires or goals of the principal and agent conflict and it is difficult or expensive for the principal to verify what the agent is actually doing. The problem here is that the principal cannot verify that the agent has behaved appropriately.

2. The problem of risk sharing that arises when the principal and agent have different attitudes towards risk. The problem here is that the principal and the agent may prefer different actions because of the different risk preferences (Eisenhardt, 1989).

The Agency Theory is a tool to use when explaining different situations that might occur in various business environments. Both the agent and the principal are looking for
a way to insure their interests of the transactions. Therefore, a bank might face a certain risk when signing this sort of agreement with a company. Moreover, it is likely that the bank wants to insure itself by taking different precaution to evaluate the information given by the company and to maintain a level of trustworthiness between the stakeholders. Furthermore, a security for the creditor is that the information about the companies is correct in order for them to evaluate the companies’ financial health and their ability to pay back loans (FAR SRS, 2006).

The main issue in the Agency theory is how to structure the contract between an agent and a principal. Since an assumption is that both stakeholders aim at maximize their own self-interests, the need for control and monitoring is strong (Jensen & Meckling, 1976). An instrument the banks can use to guarantee that the information the company gives when applying for a loan is correct, is auditing (Watts & Zimmerman, 1990). Auditing is to plan, review, evaluate and express statements about a company’s annual report, book-keeping and administration (ibid.). It is important for the companies to have auditing and the role of the auditor is to assure the quality and validity of the information (FAR SRS, 2006; Ijiri, 1983).

In Sweden every limited company is required to have an approved public accountant; furthermore, Sweden is one of two countries in the European Union that still uses statutory audit for all limited companies. However, since a few years back this obligation has been under close investigation and it has even been discussed to abolish the audit obligation for smaller companies (SOU 2008:32; Burén & Nyquist, 2005).

The first proposal on the removal of the statutory audit stated that the smallest companies would be excluded from the audit obligation. This proposal suggested that companies that have a turnover under 83 million Swedish crowns, less than 50 employees and a balance sheet total under 41, 5 million Swedish crowns, will be exempt from the audit obligation. This would mean that only 4 % of the Swedish limited companies will be obliged to have an approved public accountant (SOU 2008:32). However, on the 25th of March 2010, the Swedish government decided upon significantly lower limits; a turnover under 3 million Swedish crowns, less than three employees and a balance sheet total under 1, 5 million Swedish crowns. This proposition will come into force by 1st of November 2010 (Regeringen, 2010) and the
aim is that small companies should have an opportunity to choose whether to use an auditor or not (Gianuzzi, 2010).

However, it is vital for banks to get trustworthy information in their process of evaluating companies’ credit rating (Richard, 2008). The Swedish banking sector generally requires secured financial health, and this can be provided by the auditors (Vikström & Wahlin, 2008). Since a main objective of the statutory audit is to provide certified financial reports for the stakeholders of the companies, the banks will most certainly demand certified audit (FAR SRS, 2007). Moreover, as stated before, asymmetric information involved in credit rating systems is due to that managers always have access to more information about the financials of the companies than the banks have. Therefore, the auditing process can be considered as a “tool” for banks to evaluate this information. Furthermore, there is a great possibility that unaudited information will be negative for both the banks and the companies, if considering credit rating and lending. Since the auditing process is a vital part of banks’ assessment of trustworthy information, it is indeed possible that the banks’ credit rating systems would change if the circumstances with the auditing process would change.

In May 2006, the neighbouring country of Sweden, Denmark, decided to abolish the audit obligation for the smallest Danish companies (Frendrup-Peterson, 2009). Consequently, the removal of the statutory audit in Denmark has most certainly affected banks’ credit rating systems and in what ways banks assess information. In addition, Thorell and Norberg (2005) claim that there will be consequences for the companies and their stakeholders if the audit obligation would be removed in Sweden. Even though the proposal in Sweden suggests that smaller companies are going to be excluded from the audit obligation; banks will most likely demand certified annual reports anyhow when companies are to apply for credit (FAR SRS, 2007). Most banks view auditing as a guarantee for secured financial health in companies as well as a foundation for their credit rating process. Consequently, banks believe that the credit rating process would be unsure without the audit obligation (Andersson & Paulsson, 2005).
1.2 Problem

Auditing has various purposes (Armitage, 2008; Bottom, 1998; Fields, Lys & Vincent, 2001; Hatherly, 2009; Lee, 1995; Sami & Zhou, 2008; Sikka, Filling & Liew, 2009). Mainly, it has been argued that auditing aims at fulfilling the public interest of verifying information (Carroll 1993, qtd in Varey & White, 2000; FAR SRS, 2006; Bruzelius & Skärvad, 2004; Berman, Wicks, Kotha & Jones, 1999; Baker, 2005).

Accordingly, as stated in the background chapter, auditing is an important component of banks’ credit rating systems (Richard, 2008). Even though there are several components of bank’s credit rating systems and the assessment of trustworthy information, the auditing process is definitely an important one since it provides the foundation of this evaluation (Ijiri, 1983; Andersson & Paulson, 2005). Moreover, the role of auditing becomes strengthened and more important to examine when the statutory audit is removed as in the recent case of Denmark and later on in Sweden (Erhvervs- og selskabsstyrelsen, 2005; Frendrup & Peterson, 2009; Brännström, 2010).

Because of the existing asymmetric information, the self-interest assumption and the role of the auditing process as a “control tool”, it is difficult for banks to access trustworthy information (Hitt, Freeman & Harrison, 2001; Hsien-Hsing, 2009; Jensen & Meckling, 1976; Thomson, 2008; Verstegen, 2001; Watts & Zimmerman, 1990). The role of auditing in credit rating processes is hard to determine when banks do not have to question the importance of auditing; statutory audit secures validated information.

With an understanding of the fact that banks seek for validated information and that they assume the credit rating processes to be unsure without statutory audit, problematize the role of auditing (Andersson & Paulsson, 2005; Vikström & Wahlin, 2008; Richard, 2008).

Apart from exploring the effects of the banks’ reactions of a removal of the audit obligation, an angle of the problem is the examination of a possible comparison between two countries regarding the audit obligation. The problem that arises is whether it is possible for one country to learn anything from another country’s removal of its audit obligation. Therefore, in order to undertake this study, it is vital to
understand the main characteristics of auditing and credit rating, and especially how these are linked to each other.

1.3 Purpose

The purpose of this dissertation is to explore the relationship between auditing and credit rating. More specifically, the role of auditing in banks’ credit rating systems is going to be indentified.

1.4 Research question

Following the previous discussion our research questions is as stated:

*How is auditing being used as a tool for banks in the assessment of trustworthy information?*

1.5 Theoretical limitations

The theories which are used in this dissertation are chosen to fit the topics of credit rating, auditing and information.

Theories such as the Agency Theory, is chosen to give an overview of the asymmetric information flow, between a principal (the bank) and an agent (the company). The Positive Accounting Theory is used when explaining the same type of situation as the Agency Theory; however, with accounting as a foundation. It is explained in the Positive Accounting Theory that companies want to maximize their self-interest with accounting as a tool. The Stakeholder Model is brought up for discussion since it allows an insight into a deeper understanding of how a company’s different actions affect various stakeholders. Furthermore, literature on banks’ different parts of the credit rating processes has been explained and used in this study.

Moreover, the interest of this dissertation has been to investigate the role of auditing in the credit rating process; therefore, the stakeholder which is relevant for this study are the banks and their view on auditing and how it is used in the assessment of trustworthy information. Furthermore, the other stakeholders have not been investigated further. Thus, this study focuses on how auditing is used by banks and the importance it has in their credit rating processes. Our starting points are the foundations of the Agency
Theory, the Positive Accounting Theory and the Stakeholder Model; therefore, if other theories would have been chosen, the aim of this study would probably have been different.

Another limitation is the fact that the aim of the research is to find out how auditing is being used as a tool in credit rating processes. Therefore, as the literature shows, there are other components in the banks’ credit rating processes; however, the main interest lies in the use of auditing as a single component.

Additionally, it is important to mention that this study is restricted to Denmark and Sweden. This means that the interviewed banks are Danish and Swedish. Even though other countries would be of interest to study, we limited the investigation to Denmark and Sweden because of the convenient geographical distance.
2. Theoretical method

This chapter introduces the method of this dissertation, and the choices made within it. Terms explained and adopted in this chapter are research philosophy, research design, research approach, choice of theory and choice of methodology.

2.1 Research Philosophy

Philosophy is concerned with the way we understand the world and in what way we think about it. Consequently, the philosophy adopted in a dissertation will influence the assumptions on the facts, theories and general implications of the research (Saunders, 2009). The adopted philosophy is certainly going to affect the interpretations made by the researchers. Therefore, it is vital that the choice of philosophy is made with consideration. For example, if the research is carried out by interviews, the interpretations of the researchers and the people being interviewed are going to affect the outcome (Creswell, 2007). The foremost used research philosophies are positivism, realism, interpretivism and pragmatism (Saunders, 2009). Positivism refers to the use of existing theory, the objective analysis of observable facts and a development of hypotheses which will end in a law-like generalisation of these facts (ibid; Bryman, 2008). Moreover, the positivistic method is likely to view research as several steps where logic and many different perspectives are emphasized (Creswell, 2007). As with positivism, the second research philosophy, realism, is concerned with a strong belief and confidence in the scientific approach (Saunders, 2009). Realism is the logical approach where what you see is what you get; the reality is what we see through our senses (ibid.). Furthermore, the human nature and the complex social world are in focus in the research philosophy of interpretivism. Here, the main assumption is the view that every situation and social actor is unique. Consequently, interpretivism encourages methods where the researchers are allowed to understand the research problem from the social actors’ subjective perspectives. Lastly, pragmatism argues that the most important component of the research is the research question (ibid.). The focus of the research is moved from methods to the actual problem that is being investigated. The researchers are concentrating on the perceived outcome of the research, and they are then generally using multiple methods of data collection (Creswell, 2007).
After an overview of the philosophies, the one that is most appropriate for this study is the positivistic research philosophy. The intention is to use existing theory to create a model which will be tested on the reality. Also, the aim is that the research is going to be conducted with objective researchers who will not affect the subject of the research (Saunders 2009). According to positivism, this investigation studies different perspectives of the phenomenon and aims at developing logical steps with theories, interviews and connections between them in order to create understanding. We did not consider using realism since that philosophy gives the human nature too little power meaning that it is too persistent with examining the “world as it is” without analytical implications. Furthermore, interpretivism is the contrast to realism where subjectivism is vital in the sense that everything can be interpreted.

2.2 Research design

A research design is “a logical plan for getting from here to there” (Yin, 2003 p. 20). The research design of a study can take the form of any of the three most commonly used designs: exploratory study, explanatory study or descriptive study. The first research design, exploratory study, is appropriate when the aim of the research is to understand the nature of a problem. This design is flexible to the nature of the problem and its environment, and the direction of the research conducted should be adapted to new insights which might occur (Saunders, 2009). An exploratory study aims at understanding a problem and to build up descriptions and complicated circumstances which are unexplored in the literature (Marshall & Rossman, 1999; Kvale, 1996). There are three diverse methods within the exploratory research: a search of the literature, interviews with specialists within the topic and carry out focus group interviews. In all of these three, the focus should at first be broad but significantly narrower in the end. The purpose of the second research design, descriptive study, is to illustrate the reality of persons, events or situations. A descriptive study requires the researchers to have a clear picture of the background of the problem they wish to collect data on before the actual collection of the data. In addition, a descriptive study is most commonly used together with an exploratory or explanatory study. The third research design, explanatory study, aims at explaining a certain problem and to perform an explanation of a causal relationship between variables (Saunders, 2009). Also, an explanatory study
requires an understanding of some starting points, which should have a clear purpose and specific goals (Eriksson & Weidersheim-Paul, 2006).

This study will adopt an exploratory research design mainly because it seeks to explore the nature of bank’s credit rating systems and the use of auditing within it. In addition, the purpose of an exploratory study is to investigate a phenomenon which is somewhat undiscovered (Marshall & Rossman, 1999). We are to explore the relationship between auditing and banks’ credit rating systems, which indeed is a newly discovered phenomenon in business studies. Also, the investigation is going to be made through interviews with specialists in this field. An exploratory study also allows the researchers to be flexible in their assessment of data and to the nature of the problem, which is positive for this research because it seeks to get a deeper understanding of the problem. Thus, to accomplish an understanding of this relationship, the research is going to be conducted as an exploratory study since it states that the aim is to collect data in order to get rich explanations about the circumstances of the problem. A reason to why an explanatory study does not suit this research is the fact that a causal relationship is in focus in an explanatory study. Moreover, a descriptive study requires a clear background of the phenomenon being studied. Since this phenomenon is rather undiscovered, the background of this study is developed through existing theories as well as through the interviews.

2.3 Research approach

The two major research approaches are the inductive approach and the deductive approach. There is one major difference between these two approaches; the deductive approach moves from theory to data whereas the inductive approach moves from data to theory. A vital component of the deductive approach is that it seeks to explain causal relationships between several variables. In other words, the deductive approach uses hypotheses to confirm, reject or redefine an existing theory. Also, when using the deductive approach, the researchers want to generalize the results in order to apply the new or redefined theory on other similar cases. Another characteristic of the deductive approach is the fact that the researchers should not affect or be affected by the investigation and the outcome. Since the inductive approach is the opposite of the deductive approach, it uses gathered data collection to formulate a new theory. The main component of the inductive approach is the purpose to get a better understanding
of the nature of the problem. As compared to the deductive approach, the inductive approach is not concerned with generalization of the findings or the use of a clear research strategy (Saunders, 2009).

The main reason to why we chose to have a deductive approach to our research is because it is more suitable than the inductive one if you aim at using existing theory in the process of building a model (Saunders, 2009). As stated in the introduction, the purpose of this dissertation is to use explore the relationship between auditing and banks’ credit rating systems. Therefore, the deductive approach is preferable since we in a sense want to use existing theories in auditing and credit rating systems and explore the relationship between them. As in line with the chosen research philosophy, positivism, it is important not to be subjectively involved in the research process. In addition, the deductive approach allows us to apply the results from our study in Denmark to the possible outcomes in Sweden. The deductive approach is also a good way to define reality, since it goes from theory to practice. Consequently, the inductive research approach is not suitable for this dissertation mainly because of the use of existing theories. Furthermore, there is a great need for a clearly stated strategy in this dissertation because the aim is to apply the results in Denmark to a study regarding the possible outcome in Sweden.

2.4 Choice of theory

In order to study banks’ use of auditing in their assessment of trustworthy information, the terms of auditing and statutory audit needs to be defined and explained.

Moreover, this dissertation seeks to investigate the role of auditing in the banks’ credit rating systems. The main assumption is the asymmetric information between the companies and the banks. With the consideration of the important “security role” of auditing, this asymmetric information is of great interest for mainly the banks. Because of that, the main background and theoretical framework for this dissertation is the Agency Theory and its asymmetric information.

Furthermore, the Positive Accounting Theory is also concerned with asymmetric information. Therefore, it is of great interest for this dissertation. This theory, which is a continuation of the Agency Theory’s asymmetric information, predicts the various
options which a company has when compiling auditing and annual reports. The theory also states that the company will, through auditing, try to maximize its own utility by making assumptions and evaluations in its own interest (Watts & Zimmerman, 1978). Moreover, the Positive Accounting Theory is important for the understanding of how company managers view the auditing process with the consideration that they will try to maximize their utility. In the relationship between a company and a bank, the company is required to present easily accessed information that makes it easy for the bank to evaluate the company. To ensure that the flow of this information is correct the auditor comes in as a third party meaning that auditing will protect both parties’ interests (Ijiri, 1983). Seeing this as a reason for the companies to use auditing, it is safe to say that banks consider certified audit to be an important part in the credit-rating system.

The Agency Theory and the Positive Accounting Theory provide implications for this dissertation. However, in order to apply these ideas and relationships on banks’ use of auditing as a tool in the assessment of information, credit rating models, information and risk must be discussed.

2.5 Choice of methodology

The two major methods used when conducting research are the quantitative and the qualitative methods. A quantitative method uses numeric data whereas a qualitative method uses non-numeric data. The analysis of quantitative data is carried out by diagrams and statistics. However, the analysis of qualitative data is conducted through categorization and conceptualization (Saunders, 2009). Also, the aim of a quantitative method is to generalize the collected data in a structured and formalized way. In contrast, the aim of a qualitative method is to understand the overall impression as well as getting a deeper understanding of the problem (Holme & Solvang, 1997).

This dissertation will adopt a qualitative method. This method is appropriate because there is no need for generalizing the findings. Moreover, in order to explore the relationship between auditing and credit rating, these two concepts need to be investigated in terms of their connection to each other. Thus, the fact that the need for a deeper understanding of the problem is great underpins the choice of the qualitative method for this dissertation. In addition, the qualitative method allows this study to categorize the collected data in order to logically study the patterns with in it and
analyze the data with certain concepts in mind. The quantitative method does not suit this dissertation mainly because the research question and objectives cannot be answered through an analysis of numerical data with the aim to generalize the outcome. As stated earlier, the more appropriate research method is the one that emphasizes deeper understanding rather than generalization: the qualitative method.
3. Literature review

The literature review is presented in this chapter. The chapter begins with a presentation of auditing and statutory audit. In addition, the Agency Theory, the Positive Accounting Theory, the Stakeholder Model, credit rating, credit risk and information are explained. The chapter is concluded in a summary, where the model is presented.

3.1 Auditing

The purpose of auditing is to plan, review, evaluate and express statements about a company’s annual report, book-keeping and administration. The role of the auditor is to secure the information, and validated information generally generates more credibility to a company. The different types of auditing processes are external, internal, governmental and municipal, environmental and governmental tax audit (FAR SRS, 2006). This dissertation will focus on the external auditing process because external auditing emphasises the need for the stakeholders of the companies to be able to trust the companies.

3.1.1 Auditing and the aim of the audit process

The main purpose with auditing is that an auditor is supposed to create an audit report concerning the annual report and the book-keeping of the board of directors and the chief executive officer. However, in Sweden auditors are also expected to review the administration of companies. Furthermore, the most common mission of an auditor is to present statements about historical information. This is when the auditor compiles a report with high but not absolute security. However, if it is not completed for any reason the auditor has the choice to complete a report with limited security. In some cases, these statements may be hard to express since an auditor is supposed to declare the future utility and benefit of historical events. This is a problem because the value of the assets of a company is dependent on the future; therefore, it is impossible to make an account for an exact present value (FAR SRS, 2006).
3.1.2 Statutory audit

Statutory audit means that it is mandatory for certain companies to have an auditor who inspects their accounting and administration (FAR SRS, 2006). EC’s corporate law directive, article 51, states that the member countries in the European Union should use statutory audit. However, the same directive also mentions that the countries are free to except small companies from the statutory audit. The majority of the member countries have applied this exemption in various ways in their countries. Yet, Sweden is one of two countries in the European Union, the other one being Malta, which still uses statutory audit for all limited companies (SOU 2008:32).

In order to evaluate the meaning of the exemption of some small companies in the European Union, the term *small company* needs to be defined. The term *small company* is defined in article 5.1 in the EC’s corporate law directive as a company which does not go beyond two out of three limit values. When using the definition from the EC, 90% of the smallest companies in the European Union are exempted from the statutory audit (Erhvervs- og selskabsstyrelsen, 2005). The limit values are stated in the table below together with the limit values for the adopted exemption in Denmark and the suggested exemptions in Sweden.

*Table 1. Limit values for statutory audit exemptions*

<table>
<thead>
<tr>
<th></th>
<th>Balance sheet total (SEK)</th>
<th>Net turnover (SEK)</th>
<th>Average employees during the fiscal year</th>
</tr>
</thead>
<tbody>
<tr>
<td>EC</td>
<td>41 019 000</td>
<td>82 038 000</td>
<td>50</td>
</tr>
<tr>
<td>Denmark</td>
<td>2 025 450</td>
<td>4 050 900</td>
<td>12</td>
</tr>
<tr>
<td>First proposal Sweden</td>
<td>41 019 000</td>
<td>82 038 000</td>
<td>50</td>
</tr>
<tr>
<td>Second proposal Sweden</td>
<td>1 500 000</td>
<td>3 000 000</td>
<td>3</td>
</tr>
</tbody>
</table>

*(Based on: Erhvervs- og selskabsstyrelsen, 2005; SOU 2008:32; Brännström, 2010)*

The statutory audit in Denmark was removed on the 1st of April 2006 and the limit values were as mentioned in table 1. With the Danish limit values being approximately 2 million SEK for balance total and 4 million SEK for net turnover, 75 000 out of the 130 000 “b-virksomheder” (58 %) are excluded from the statutory audit (Erhvervs- og selskabsstyrelsen, 2005; FAR SRS, 2007).
Furthermore, the statutory audit in Sweden was introduced in 1983 and demanded every limited company to use a certified auditor. In addition, some other companies such as certain trading partnerships were also included in this statutory audit (FAR SRS, 2006). The first proposition to leave out some smaller companies from the statutory audit in Sweden first came in 2006, with the limits values from the EC in mind (SOU 2008:32). This is illustrated in table 1. where the limit values in the EC are the same as for the first proposal in Sweden. However, the most recent proposition determines much lower limit values; 1.5 million SEK for balance sheet total and 3 million SEK in net turnover. This second reform comprises 70% of the smallest companies in Sweden and is going to come into force the 1st of November 2010 (Brännström, 2010). Even though it is decided that the audit obligation is going to be removed, the Swedish government predicts that the probability that the affected companies will keep their auditor is high because of the fact that auditing is a quality stamp for banks in their credit rating processes (Regeringen, 2010). Even though more companies in percentage are excluded from the statutory audit in Sweden then in Denmark, the newest proposal in Sweden makes it easier to compare the two countries’ debates regarding the statutory audit. First, the limit values are rather alike. Second, both the Danish and the Swedish regulations have set the main reason for the removal of the statutory audit to lower the costs for smaller companies (Erhvervs- og selskabsstyrelsen, 2005; SOU 2008:32).

3.2 Agency Theory

One of the reasons for a company to use auditing is the assumption that auditors serve the public interest to secure the information involved (Watts & Zimmerman, 1990; Lee, 1995). In this regard, the main role of an auditor is to secure the information for the stakeholders of the companies (FAR SRS, 2006). Moreover, the fact that banks believe that the credit rating process would be unsecure without the audit obligation (Andersson & Paulsson, 2005) illustrates the importance of auditing and auditors. When banks evaluate the financial trustworthiness of small- and medium sized companies, certified audit is an essential component of the evaluation process (Skenberg & Kreivi, 2006).

The Agency Theory is concerned with the relationship between two main persons/groups; the principal and the agent (Jensen & Meckling, 1976; Eisenhardt, 1985; Verstegen, 2001; Bruzelius & Skärvad, 2004; Thomson, 2008; Hitt, Freeman & Harrison, 2001). The agency relationship is one of the oldest defined forms of social
interactions and includes a person/group, the principal, who delegates assignments to a person/group, the agent (Ross, 1973; Eisenhardt, 1985). This specific type of relationship exists in any business environment and is vital for people and organizations to understand in order to have functioning situations (Jensen & Meckling, 1976; Eisenhardt, 1989). A relationship between an agent and a principal may arise in any relationship where there is a separation of ownership and control (Collins, 2003). The presumption in the Agency Theory is that the relationship between an agent and a principal is mutual and that the agent undertakes something on the behalf of the principal. However, problems emerge because of the assumed asymmetric information meaning that the principal only has indirect information about the actions of the agent (Verstegen, 2001). The foundation of the Agency Theory is based on seven main assumptions:

**Human assumptions:** (1) humans tend to act in their own self-interests, (2) lack of information and time limits humans to be rational in their decision-making process and (3) humans have different risk perceptions.

**Organizational assumptions:** (4) both actors tend to have different goals, (5) both actors aim at maximizing their own prosperity and (6) it exists asymmetric information among the actors where one actor knows more than the other.

**Information assumption:** (7) information is a commodity that can be bought.

(Eisenhardt, 1989 p.59)

The general implications derived from these assumptions are that the agent knows more and has access to more information than the principal, and that it is hard for the principal to correctly monitor the agent (Adams, 1994). Furthermore, there are two types of information asymmetry which occur in the agent-principal relationship: adverse selection and moral hazard. First, adverse selection deals with the fact that the agent has more information than the principal. Second, moral hazard refers to the difference of incentives and interests of the agent and the principal (Thomson, 2008). Since the agent and the principal differ in goals, it becomes vital to consider and understand the fact that information in the Agency Theory is regarded as a commodity. This assumption means that information may travel faster and can be purchased. Thus, a principal can control its agents by controlling the information systems within and across a company (Eisenhardt, 1989).
In addition, an agent and a principal tend to differ in time perception. A principal, for example the bank, usually has a long-term time horizon whereas an agent, for example a credit seeking company, typically has a short-term time horizon (Banks & Sundaram, 1998; Luthans, 2002). Furthermore, because of the mentioned characteristics and problems with the Agency Theory, the agent-principal relationship needs control and monitoring. The control is important because companies are perceived as consisting of many contracts between several individuals or groups with self-interest (Fama, 1980). The fundamental part of the relationship for the principal is to make sure that the agent acts in his/her best interest (Bruzelius & Skärvad, 2004). This is mainly accomplished by a contract based on either behaviour or outcome. The component that determines which type of contract that will be suitable for a certain situation is whether the behaviour or the outcome is in focus. If a particular behaviour is demanded the contract will preferably be a behavioural one. In contrast, if the outcome is in focus, an outcome based contract is more appropriate (Eisenhardt, 1989).

In summary, one way to solve the problem in the Agency Theory regarding control and monitoring is to use an auditor. Certified information, conducted by an auditor, may very well serve as a third party meaning that the asymmetric information is likely to be reduced. Auditing and its certified information is one way to reduce the primary issue in the agency theory; asymmetric information (Thomson, 2008).

3.2.1 Positive Accounting Theory

In accordance to the Agency Theory, the Positive Accounting Theory is based on the assumption that individuals and groups act out of self-interest. With this assumption, the companies’ choice of accounting method becomes crucial to understand because this means that the agent will aim at maximizing his wealth and that the principal at the same time will aim at maximizing his wealth (Mouck, 1992; Collin, Tagesson, Andersson, Cato & Hansson 2008). The contract between an agent and a principal, as assumed in the Agency Theory, is the assurance of a functioning relationship and an auditor may in this case act as a third party who ensures both parties’ interests (Watts & Zimmerman, 1990).

The Positive Accounting Theory discusses the existence of contracting costs within and across an organization. These contracting costs consist of transaction costs, agency
costs, information costs, renegotiations costs and bankruptcy costs. Furthermore, the various contracting costs can help to explain accounting and accounting would not exist without contracting costs (Watts & Zimmerman, 1990). Since the Positive Accounting Theory predicts that both agents and principals act in self-interest, contracts are needed to regulate the behaviour and the outcome of the contracts. Without regulation, the theory states that agents would act in their best self-interest rather than in the best interest of the principal (Collin et al., 2008). In addition, the management of a company would pursue the accounting method which would present the company’s financial information in their best perspective (Fama, 1980).

Various accounting methods are chosen from factors such as bonus plan, debt contract, political process, leverage and size (Watts & Zimmerman, 1990). If, for example, a company has good leverage the management is likely to pursue an accounting method which enhances the leverage. Consequently, three hypotheses are derived from this line of argument: ceteris paribus,

(1) Managers of firms with bonus plans are more likely to choose accounting procedures that shift reported earnings from future periods to the current period,
(2) the larger a firm’s debt/equity ratio, the more likely the firm’s manager is to select accounting procedures that shift reported earnings from future periods to current period,
(3) the larger the firm, the more likely the manager is to choose accounting procedures that defer reported earnings from current to future periods.

(Mouck, 1992, p. 40)

The fact that managers want to show off the company from its best side is also connected with the fact that the aim of the managers should be to lower the contracting costs. However, to show its best side and to lower its contracting costs are certainly arguments which have to be considered in the process of choosing an accounting method for a company (Fama, 1980).

The original aim of the statutory audit in Denmark was to facilitate for the owners of the company to trust the accounts which the managers presented (SOU 2008:32). The Positive Accounting Theory predicts that any agent-principal relationship needs control and monitoring as well as a third party who ensures the outcome of the relationship. In accordance to the aim of the removal of the statutory audit in Denmark, the purpose of accounting is to guarantee a fair system of correct information between a company and
its stakeholders (Ijiri, 1983). Watts and Zimmerman (1990) refers to this aim by discussing the “information perspective” in the Positive Accounting Theory. Since the main intention of auditing is to secure the information between a company and its stakeholder (FAR SRS, 2006), an auditor could indeed be the third party who bridges the issues mentioned in the Positive Accounting Theory.

3.3 Stakeholder Model

Auditing is performed to meet the demands and needs of the stakeholders of the companies (FAR SRS, 2006). Hence, it is important to understand which the stakeholders are and which demands they might have on companies. The Stakeholder Model describes the relationship between an organization and its stakeholders such as individuals, groups and other organizations which are interacting with the organization (Bruzelius & Skärvad, 2004). Hitt, Freeman and Harrison (2001 p. 189) define a stakeholder as “any group or individual who is affected by or can affect the achievement of an organization’s objectives”. This relationship means that the organization and the stakeholders are mutually dependent on each other (Bruzelius & Skärvad, 2004). By looking at the interests of all of the companies’ stakeholders, the Stakeholder Model acts as a counterbalance to financial theories which assume that companies only strive at maximizing the profitability of their shareholders (Orts & Strudler, 2002). It is of great interest for an organization to consider its stakeholder when evaluating and making decisions. These considerations should, according to Carroll (1993, qtd in Varey & White, 2000), be made with two regards; stakeholders which the organization thinks have an interest in them and stakeholders those themselves believe have an interest in the organization.

The eight stakeholders of a company are: the owners, the interest organizations, the employees, the managers, the customers, the suppliers, the creditors, the society and the opinion leading groups (Grönlund, Tagesson & Öhman, 2005). These stakeholders are illustrated in figure 1.
In order to understand the interaction of the different stakeholders, it is important to define and describe the meaning of each and every stakeholder. The owners contribute with capital to the organization and want the organization to be profitable because they expect a certain return on their equity. The interest organizations argue for the employees’ best interests. The employees seek salary and other compensation in return for their work performance in the organizations. These compensations can take the form of for example a satisfying salary, a good working environment, and the right to be a part of the decision making process. The managers contribute with their working performance and aims at getting a good salary for it. Furthermore, the customers might be the most important stakeholder of organizations. Without the customers, the organizations would not be able to survive. The customers contribute with buying services or products from the organizations and giving capital in return. However, the customers demand services or products to a fair price and quality. The suppliers contribute to the organizations’ activities by supplying it with services and products. At the same time, the suppliers expect the organizations to be stable and reliable.
customers. The *creditors* supply the organizations with capital and expect the organizations to pay interest and amortize the granted loans at a given time. The *society* contributes to the organizations by supplying services such as education, infrastructure and residences. In addition, the society can also grant loans to the organizations. In return, the state and community want organizations to pay taxes and contribute to the even employment of the society. The *opinion leading groups* are groups which have an interest in a certain organization (Bruzelius and & Skärvad, 2004).

One issue in the Stakeholder Model is how the different stakeholders perceive themselves and how they are perceived by others (Welch & Jackson, 2007). Therefore, it is of great importance for the organizations to understand the behavior of their stakeholders. Since it is vital for the organizations to consider each and every stakeholder, the perspective of the companies should be broad and consistent for the different stakeholders (Varey & White, 2000; Berman, Wicks, Kotha & Jones, 1999; Bruzelius & Skärvad, 2004). However, the stakeholders of a company may have different views on what is in the best interest for them and the company. The companies need to evaluate and judge the different stakeholder’s interests and demands and find a reasonable balance among them (Bruzelius & Skärvad, 2004). It is in the companies’ top management teams’ responsibility to try to accomplish each and every stakeholders’ interest. Only in that way is it possible for companies to maximize their utility and profitability (Varey & White, 2000). Communication can be a useful tool for companies in their assessment of information from their stakeholders or when overcoming problems in stakeholder relationships (Welch & Jackson, 2007).

Auditing is internationally perceived as occurring in the public interest and all stakeholders can cash in on the advantages of auditing (FAR SRS, 2006). However, the creditors are the stakeholders which are going to be affected the most by the removal of the audit obligation (SOU 2008:32). Companies are accountable to their creditors, and they are obligated to provide them with certain information (Ijiri, 1983). The creditors, namely banks, may set demands for companies on factors such as board composition, management and capital structure (Thomson, 2008). Reports are a ground for the creditors in order to make decisions on whether to grant a loan to a company or not (SOU 2008:32). Furthermore, certified annual reports may be an indication that a company is reliable or not (Kaur, Kristensson & Kurt, 2007). In order to meet the
stakeholders’ interests and demands, companies need a tool to interpret information and the role of the stakeholders. The relationship a company has with its bank may indeed be the most important relationship a company has (Thomson, 2008). In this kind of relationship, an auditor can serve as a third party who secures the information as well as both parties’ interests. Furthermore, creditors would indeed demand secured information in other ways if auditing did not exist (FAR SRS, 2006).

3.4 Credit and Credit risk

Credit is originated from the Latin word “credere”, which means to trust somebody (the Latin Dictionary, 2010). When it comes to the banking sector, there is a great need for validated information when granting a loan. An important source that banks tend to review in order to evaluate if a company has enough credibility to be granted a loan is the annual report. A problem might be the fact that annual reports are written a few months before the credit rating processes, so banks are likely to ask for further information in order to decide whether or not to grant the loan. There are diverse evaluation processes which banks conduct and there are various components that are taken under consideration in the credit rating system. One of these factors is risk. There is a level of uncertainty in the credit rating processes which banks face. That is why, in the credit rating systems, banks will try to reduce this level of insecurity (Tegin, 1993; Strenger, Hallin & Sanden, 2008; Loubergé & Schlesinger, 2005).

There are two different kinds of risks: the risk before the company’s bankruptcy and the risk when the company is bankrupt. The first risk involves what happens if a company can not act according to the agreement with the bank in terms of interest rate and amortization. Banks always have to take into consideration the fact that a company may go bankrupt and will not be able to pay. Factors such as a company’s business concept, management competence, strategies and market estimations are all parts of the evaluation of the first risk. The second risk is to estimate the real value of the security when a company goes bankrupt (Tegin, 1993). To see to that there are no factors in the credit rating processes that are neglected banks are regulated by Swedish law (2004:297 Lagen om bank och finansieringrörelse 8 kap 1-2 §).
3.4.1 Credit rating

To evaluate the financial health of a company and its ability to pay interest and capital, banks use different financial models based on financial information. One model used is Altman’s five C:s, which are capacity, character, capital, collateral and conditions (Altman, 1985 qtd in Svensson, 1999). By using the balance sheets, income statements and annual report, banks analyse the information with focus on capacity of the companies. This means that banks will look at companies’ annual reports to find out if they have credibility to be granted a loan (Tegin, 1993; Svensson, 2003). With the analyzed information, banks calculate and evaluate a company’s financial ratios such as solidity, liquidity and profitability. Another factor which is important to look at when evaluating the companies’ ability to pay back loan is the cash flow. Beaver (1994 qtd in Svensson, 1999) found out that the cash flow is an indicator of crises to come for the company. Altman (1993 qtd in Svensson, 1999) agrees and states that even though cash flow is an important indicator, profitability is even better in predicting a crisis.

Moreover, there are also qualitative characteristics which are important in the banks’ credit rating systems. The willingness to pay back loans and honesty are qualitative factors which are important. It is also essential for the bank to have good relationships with the companies. Another actor close to this relationship which also is an important assessment for the firms is the accountant (Svensson & Ulvenblad, 1994).

The credit rating processes have three parts; the gathering of information, the process of information and the interpretation of information. The credit rating process is an ongoing process in which the creditor conduct a credit evaluation throughout the entire time an agreement is made between a company and a bank. This means that the assessment of information is made in a long run sense, and that the banks will use follow-ups, control and supervision. Svensson (2003) brings up three areas which the credit rating process is based on: the company’s future earning, its ability to pay back given loans and the value of the company’s security in case of a future realization. The historic, present and future information are all used in this process in order to make a good decision. However, the banks try to make an evaluation of the companies’ working ethics and paying moral. This means that if the company is already a client with the bank, it can be an advantage for the companies if they have a good relationship
with the bank. The relationship a bank might have with a client is a key factor in the evaluation process because a bank has internal information about the client’s economy and personal information (Funered, 1994).

3.4.2 Information

There are different ways in which banks can assess information from companies, and one important component is the information they can acquire from the client. To make the process easy and to make sure the decision is correct, information about a company’s capital structure, rate of return, check-out and growth rate are important in the credit rating process. If the client has strong stockholders’ equity and low leverage, the chance of obtaining a credit with the bank is likely to increase. The banks will also evaluate the cash flow and liquidity for a longer look into the future. The estimation about a company’s current and future state will give the banks an indicator about the way the company will prosper. It will also allow the banks to see difficulties and opportunities the company will face even though this is a process that is not always accurate. Historical financial ratios with the right combination and relevance can make a good prognosis of a company’s ability to survive (Tegin, 1993).

Banks also want to take the company’s business plan, investment plan and vision into consideration in the credit rating process. Another factor which banks investigate for the company is the market in which the company is present. If it is a tough business and the company struggles with finding costumers, it will affect its opportunity to be granted a loan. Additionally, the business idea is another factor that plays a part in banks’ evaluation of the company (Tegin, 1993; Sigbladh & Stenberg, 2003).

The importance of information is always highlighted in credit rating processes, and the level of risk diminishes when the company has certified information. Even though there are parts in the annual report that are more important than others for the banks, it is the overall impression of the company applying for a loan that is of greatest interest. Furthermore, banks are not interested in paying for supplement information if this is needed in the process; they even sometimes refuse the profit of this extra information if it is of great cost for the company (Svensson, 2003).
3.5 Summary

Figure 2 summarizes our literature review and describes the credit rating process in banks with an emphasis on audit. The accounting assessment includes auditing and the role of the audit process. As described in figure 2, there are two flows of information from a company to a bank. The first category is qualitative information which involves honesty, willingness, length and strength of the relationship between a company and a bank, as well as, the vision and business plan of a company. The second category, quantitative information, refers to components such as financial statements from the annual report and different financial models.

There are certain assumptions explained in different theories which cause problems in this model. The main perspective that the model illustrates is the fact that banks aim at reducing their level of risk (Tegin, 1993; Strenger & Hallin & Sanden, 2008). Risk reduction may be accomplished in various ways; however, this model predicts that banks accomplish this by using certified information conducted by an auditor as well as by establishing relationships with their clients (the companies). One problem in this model concerns the asymmetric information as mentioned in the Agency Theory. If the company has access to more information than the bank and if the interests of the company and bank differ, the risk of the bank becomes greater because of this uncertainty. The Positive Accounting Theory takes the Agency Theory a step further by pointing out that both the agents (companies) and the principals (banks) always act in their best self-interests (Collin et al., 2008). This statement makes it even harder to accomplish the main objective of auditing, which is to secure the involved information (FAR SRS, 2006). Another issue in this model, which the Stakeholder Model refers to,
is the fact that companies should provide the banks with trustworthy information. If the companies provide this information with the help of an auditor, the information becomes certified and the risk of the banks is reduced.

![Figure 3. Model for accounting assessment for banks – without statutory audit](image)

As a conclusion, the important parts of this model are the accounting assessment and the information flows derived from the companies and the way in which they are transferred and interpreted by the banks. The assessment of information becomes especially vital to understand when the statutory audit is being removed for the smallest companies. The model illustrates the complexity of the credit rating process, proving the fact that even with certified information from their clients; banks must have various ways of controlling the authenticity of the information. To make sure that the information is valid, involving a third party, for example an auditor, will probably increase the level of trust between a bank and a company. In conclusion, the main issue, which figure 3 illustrates, is how a removal of the audit obligation will affect the accounting assessment and how unaudited information may be interpreted by the banks. If the statutory audit would be removed, some smaller companies have the option to exclude an auditor meaning that their annual reports will unaudited. For that reason, it is interesting to examine if and how the banks’ use of auditors will change. The use of auditing in banks is somewhat researched, but the problem is consequently to which extent a change in the demand for certified information will affect the banks’ evaluation of companies’ level of trustworthiness. In our research, we intend to study this issue with the case of Denmark and Sweden as backgrounds.
4. Empirical method

This chapter starts with a discussion about the research design, strategy and time horizon of this dissertation. Furthermore, considerations and choices regarding data collection, sample selection and operationalization will be made. Finally, the matters of validity, reliability and generalisability are discussed.

4.1 Research design and strategy

The purpose of this dissertation is to explore the relationship between auditing and credit rating, and to determine the importance of auditing banks’ credit rating systems. The chosen research question will, in this chapter, be transformed into a research project with the help of a research design and strategy. The study is carried out with a certain sampled data. How we decided to select the sample and collect the data of this dissertation will be thoroughly explained in this chapter. Moreover, the framework of this dissertation needs to be defined in terms of reliability, validity and generalisability (Saunders, 2009).

The overall plan of this dissertation depends on which research design we decide to undertake. As stated in chapter 2.3, this study was conducted using the exploratory research design. Based on the literature review, we have created a model which we intend to test in this study. This chapter aims at describing how we conducted this study, as well as explaining the implications derived from the chosen research design of exploratory study. One main assumption that follows the choice of an exploratory study is the purpose to contribute with a new perspective to already existing theory. In other words, we intend to study a rather new relationship; the one between auditing and banks’ credit rating system. Also, it is indeed favorable for the nature of our research question and objectives to conduct an exploratory study which allows more flexibility.

The choice of research strategy is important, and it should match the research questions and objectives. The seven different research strategies are as followed: (1) experiment, (2) survey, (3) case study, (4) action research, (5) grounded theory, (6) ethnography and (7) archival research (Saunders, 2009). This investigation will be carried out as case studies with the main focus being to study a current phenomenon (Yin, 2003). The aim for a case study, as well as for this dissertation, is to achieve a rich understanding for this particular phenomenon and the concepts involved (Saunders, 2009).
4.1.1 Time horizon

Another important characteristic of the dissertation is the insight in time horizon. The choice of time perspective should reflect the research question, and the two different time horizons are cross-sectional and longitudinal. The cross-sectional perspective studies a particular problem at a given time, whereas the longitudinal perspective studies a particular problem over a time spectra (Saunders, 2009). A cross-sectional study is the collection of quantitative or quantifiable data on more than one case or more (normally mane more) variables. The aim of a study with a cross-sectional perspective is to examine the collected data and discover patterns of association (Eriksson & Weidersheim-Paul, 2006). In contrast to the cross-sectional perspective, the longitudinal perspective focuses on studying change and development; therefore, it is necessary to conduct the study during a given time spectra (Saunders, 2009). Since the variables are studied during time, it is with a longitudinal perspective possible to examine a casual relationship since the researchers are able to study the variables in time order (Eriksson & Weidersheim-Paul, 2006).

This dissertation is going to be carried through with a cross-sectional perspective, with the main reason that we aim at studying the use of auditing in banks’ credit rating processes at a given time. Also, this bachelor thesis has time constraints which do not allow us to study a phenomenon over a time period (Saunders, 2009). Furthermore, the interesting characteristic of this phenomenon is to collect data to develop an understanding of and explore the relationship between auditing and credit rating processes. To explore a relationship and understand a particular phenomenon is also in line with the choice of an exploratory research design. Therefore, it is of interest to study the development from the day the audit obligation was removed in Denmark until today, as well as possible developments in the near future. In other words, we are to explore a relationship by discovering a pattern of associating events rather than exploring the phenomenon during a time spectra. The cross-sectional time horizon is also appropriate for a study which is going to be conducted through interviews over a short period of time (ibid.).
4.2 Danish banks

The following paragraphs explain the data collection, sample selection and operationalization for the interviews conducted with Danish banks.

4.2.1 Data collection

The data which should be collected in order to answer the research question and objectives may be collected through two types of data; primary data and secondary data (Saunders, 2009; Eriksson & Weidersheim-Paul, 2006). Primary data refers to the collection of new data which are suitable for the purpose of a certain dissertation. The collection of primary data can be carried out in various ways, e.g. observations, interviews and questionnaires. In contrast, secondary data is collected by a reanalysis of already collected data for another purpose. There are three different types on secondary data: documentary, multiple sources and survey (Saunders, 2009).

The main data collection of this dissertation was the collection of primary data. For an exploratory study, it is advantageous to use interviews in order get a deeper understanding of the opinions and attitudes of the participants. The collection of this primary data is going to be conducted through interviews with experts in credit rating within Danish banks. A discussion of the selection of these banks is developed in the next paragraph. The two types of interviews are standardised respectively non-standardized. We used a specific type of interview within the section of non-standardised interviews; face-to-face interviews (Saunders, 2009). This specific type of interview is appropriate for this dissertation because it allows the participants to develop a discussion regarding the problem and the interview questions.

Furthermore, in accordance to the research question and objectives, this study aims at collecting a large amount of credible data and perspectives on the problem, rather than generalising the collected data. The reason to why this dissertation relies mostly on primary data is the fact that the topic is rather undiscovered. As mentioned in chapter 4.1.1 regarding the choice of a cross-sectional time horizon, a phenomenon may be explored in a longitudinal perspective even though the time period given is restricted. The phenomenon could then be studied with the help of secondary data collected and re-analysed (Saunders, 2009). However, our phenomenon is rather undiscovered and
the necessary data for an analysis of secondary data is not available. In other words, the secondary data available is not sufficient enough to answer our research question or meet our research objectives.

4.2.2 Sample selection

Although it may be possible for some research questions and objectives to use the entire population (census), it is often required and more suitable to use some cases within the entire population (sampling). There are different ways of selecting the appropriate sample for a research. The two main headings are probability sampling and non-probability sampling. From these two, various subheadings are derived. Probability sampling is generally tied with studies conducted by surveys and experiments, and the point is that the chance for each case to be chosen is known and equal. As for non-probability sampling, however, the chance for each case to take part of the study is unknown. A probability sampling allows statistical measurements and generalisation, whereas non-probability sampling can generate generalisations but not correct statistical measurements (Saunders, 2009).

The population in this dissertation is banks in Denmark. However, to be able to analyse our research question and objectives there is a great need for sampling. Thus, some limitations of the population need to be made. First, we only included banks within Copenhagen because we did not have the necessary money or time to conduct research outside that area. Second, the research question and the model derived from the literature review are only adequate to test on banks with a department for credit rating of companies (compared to only credit rating for individuals). Third, the banks selected must have operated in the Danish market since at least the year of 2005. This limitation needs to be made with the regard that the banks must have been evaluating companies both with and without the statutory audit to be able to make accurate replications concerning it.

To summarize, the population from which we sampled our cases were Danish banks in Copenhagen which have had operations in credit rating of companies since the year of 2005. In addition, Danish banks which fulfil the recently mentioned criteria were favoured in the selection process if they have operations in Sweden. The reason to this
distinction is the fact that it makes it easier for us to contact and evaluate these banks with regard to the removal of the audit obligation in Sweden.

Since there is no clear sampling frame for our population, and the time is too short to make one, we used non-probability sampling. Moreover, it is necessary for the objectives of this research that the sample and the chosen participants have the required knowledge and information to be able to answer our questions and understand the problem correctly. Thus, it is more vital for this research to get few but useful participants than many but not very useful participants (ibid.).

From this narrow population we sample our participants by using a combination of self-selection and convenience sampling; both sampling methods belonging to the non-probability sampling (ibid.). We use the self-selection sampling by sending e-mails to the banks in the selected population with regard to the limitations mentioned above. In addition to this, the convenience sampling is used because we do not send e-mails to certain banks if we do not find any addresses to them. However, this method may be considered as being part of the purposive sampling since we include the biggest and most well-known banks (they usually have e-mails on the web pages), and exclude the smaller and not well-known banks (they usually have limited information on their web pages). As mentioned above, the participants in our investigation must have certain knowledge in credit rating and an assumption from our side is that the smaller and less unknown banks in Denmark might not have possess this knowledge.

4.2.3 Operationalization

When writing a dissertation, theory after theory is brought up to discussion, with no further explanation or connection to reality; therefore, it is important to thoroughly explain how they are going to be used and connected to reality. There are different concepts that are used and these need to be described into more measurable terms, this to insure the validity and reliability of the paper. The validity, reliability and generalisability are different types of measures of the quality, rigour and wider potential of research (Mason, 1996). This process is called the operationalization process (Eriksson & Weidersheim-Paul, 2006). In other words, research questions and objectives are put into more measureable variables in order for the researchers to fully understand them.
Before introducing the interview guide, there is a need to specify and define certain terms which are important in this dissertation. These terms are as follows:

**Auditing**: a process conducted by auditors where a company’s accounting and administration are evaluated, with the aim to provide information to the public (Nationalencyklopedin, 2010).

**Tool**: a factor which facilitates for the banks to access information about companies in order to conduct credit ratings.

**Information**: quantitative and qualitative information about companies which banks use in their credit rating processes.

**Credit rating**: a process where a company is evaluated in terms of creditworthiness, with the aim to create an agreement between the company and the bank.

In this dissertation we carried out interviews with three Danish and two Swedish banks. We want to gain a deeper understanding of banks’ credit rating processes and find factors that are common for the Danish and the Swedish banks. We have constructed an interview guide with ten questions.

The interviewees preferred to see the interview guide beforehand; therefore, we sent it to them a few days before the interviews. This made the interviewees feel more secure, and allowed them to think through their answers. After the interviews, we sent transcripts of the interviews to the bank, in order to get their approval. When notified that the banks agreed on the transcripts, these transcripts were narrowed down into summaries which are introduced in chapter 5. Below, the interview guide is presented, followed by explanations to the choice of questions.

4.2.3.1 Interview questions

**Question 1**: *How big is your lending activity with small vs. big companies? (Definition of small company in accordance to the limit values for the Danish statutory audit)*

The aim of this question is provide the research with background information and to make us understand the banks’ perspectives on the use of certified audit. Depending on
the banks’ lending activity with small companies, the removal of the statutory audit may or may not be of great influence for the bank.

Question 2: How is the credit rating process conducted in your bank?

Question 3: Which components of a company are important in your credit rating process? How would you rate them and compare them to each other? Which is the most important?

Question 4: Which role does auditing play in the credit rating process?

In order to determine how the interviewed banks have changed their credit rating processes we need to define and categorize the components of their credit rating processes. Questions two and question three aim at gaining an understanding of the credit rating processes, whereas question four is a more direct way of determining the importance of auditing. These questions will explain how auditing is being used as a tool, which is a main part in figure 2.

The financial theories state that components like a company’s future earnings, solvency, the value of the security in case of a future realization, its business plan, its investment plan and its vision are all part of credit rating processes which banks conduct (Tegin, 1993; Sigbladh & Stenberg, 2003; Svensson, 2003). Questions two and three are directed at explaining which components are of greatest interest. Also, it is important to ask these open questions to make sure that our literature review covered all the vital characteristics of banks’ credit rating processes. If not, these questions will point out that there are more necessary components to consider in banks’ credit rating processes.

With questions two and three, we seek for open up a discussion, whereas the aim of question four is to introduce the concept of auditing. Moreover, we want to introduce the concept of auditing in a rather early stage since the concept is, in accordance to the research question, the foundation of our study. In addition, by first introducing the credit rating process and then the importance of auditing, the interview gets a clear structure in line with the relationship of credit rating and auditing. In this way the validity of the research increases because the link between credit rating processes and auditing is clearly stated (Saunders, 2009). We state that the reliability of the research
increases by asking the interviewees questions about their credit rating processes before mentioning auditing because it allows the interviewees to speak freely without the feeling pushed the direction to only discuss auditing. Furthermore, the reliability will also be high because these questions are open and far from being leading (Kvale, 1996).

**Question 5:** How did you and your bank react when it was decided that the statutory audit was going to be removed for the smallest companies?

According to our literature review, banks were positive to the former Danish statutory audit (Tegin, 1993; Strenger, Hallin & Sanden, 2008; FAR SRS, 2007). Therefore, it is important for us to know what the banks think about the statutory audit in Denmark, and if they think it was right or wrong to remove it for the smallest companies. One consideration regarding this is the fact that reliability partly refers to the extent to which the interview questions are connected to the theories studied (Miles & Huberman, 1994). For that reason, it is interesting to question whether the interviewed banks are positive to statutory audit. According to figure 3, the risk involved in the lending process will be more emphasized, which probably this question will give us an understanding of.

The aim of this question is to introduce the concept of statutory audit in order to lead the discussion in that direction. We believe that not more than one concept should be introduced in one question in order to create a logical read threat. In addition, this structure increases the validity of the research since open but rather specific questions will make the interviewees answer according to our expectations. Moreover, question five is a forerunner to question six, meaning that we with question five seek at get the general opinion of the bank representative and its bank regarding statutory audit. By doing this, the reliability increases because the question will be answered freely without any connection or thought of how the bank has modified its credit rating process according to the modification of the statutory audit. In other words, we are interested in the banks’ first impressions of the modification of the statutory audit in 2006 without him/her having to take the actual changing process in its bank into consideration.
Question 6: *Has the credit rating process changed after the modification of the statutory audit? How?*

Asking this question after knowing the banks’ first impressions of the modified statutory audit, is a good transition of connecting banks’ credit rating processes and statutory audit. If considering figure 3, there is an implication that the credit rating process will undergo a change after the removal of the audit obligation. This question allows us to measure possible changes in figure 3, due to the fact that using an auditor becomes eligible. Hence, the role of auditing in credit rating processes might be more or less emphasized due to the removal of the statutory audit.

This is the first time in the interview where we present and lead the discussion to the main objective of the research; the changed credit rating process due to the modified statutory audit. Because of this, this question is necessary for the validity of the research. Also, the interpretive validity increases by asking this question because it is directed at the people involved in the changing process (Miles & Huberman, 1994). In our case, the people are the interviewed banks.

Question 7: *Does the importance differ depending on if the annual report is certified by an auditor or not? If that is the case, in what ways does it differ?*

An interesting view is the one that certified information tends to have a quality stamp, since a third party, the auditor, has “approved” the information involved. Banks also tend to believe that credit rating processes might be unsure without the audit obligation (Andersson & Paulsson, 2005).

This question will give us an understanding of the fact that most banks probably will demand audited annual reports, since a main purpose of the statutory audit is to provide certified financial reports for the stakeholders of the companies (FAR SRS, 2007). We also want to see whether or not banks are more or less interested in an annual report depending on if it is certified by an auditor or not. By posing this question, the importance of an auditor is determined. Moreover, if referred to figure 3, the accounting assessment is measured in terms of an auditor. In other words, this question measures the relationship between an auditor, the accounting assessment and a bank. The aim is
to determine how an auditor affects the accounting assessment and a bank, and if the accounting assessment differs for a bank depending on if a annual report is audited or not.

The validity of this research will increase since one of the main aims is to see if annual reports are important for banks if they are audited by an auditor or not. Thorell and Norberg (2005) argue that banks view auditing as a convenience factor rather than a factor of real importance, so it is appealing to see the banks view of this issue. The reliability will increase given that this question is saved for the end of the interview when a level of trust might have been accomplished and the answers to the questions will reveal a more in-depth pace, in which we discuss auditing more freely.

Question 8: How does the credit rating process for a new client with no certified annual report or information look like, after the removal of the audit obligation?

We want to see how the credit rating processes have changed, if they have changed, and if the banks now have to take other components into more consideration, like information given by the companies themselves. Less certified information might have triggered the banks into conducting other models. Since it is a security for the creditor that the information about the company is correct (FAR SRS, 2006), banks will probably demand certified annual reports anyhow when companies are to apply for credit (FAR SRS, 2007). This since it is important for the banks to have trustworthy information in their credit rating process (Richard, 2008). This question will hopefully help us to get an understanding of the credit rating processes and the changes the banks have gone through after the removal of the statutory audit.

The validity will increase because we want to know what type of changes the credit rating processes have gone through and the role auditing plays in them, which this question hopefully will define. The reliability of this research question will probably increase since we do not have to guide the interviewees in any directions, but let the interview have a natural course. In other words, in order to “transform” the interviews into conversations, we develop and maintain a red thread by asking the questions in a logical pattern. This question is a logical follower to the one before, and it turns the interview towards the importance of auditing in banks’ credit rating processes.
Question 9: Does the importance of a certified annual report differ if you have a good relationship with the client? How?

It is stated that beyond the numbers, the cash flow and banks’ different credit rating models, having a good relationship with the bank is something that plays a major role in whether or not a loan will be granted (Svensson, & Ulvenblad, 1994). This question will give us an understanding of whether or not this type of relationship is an indicator that has an important role for banks in their credit rating systems. If the company is already a client with the bank, the bank will have internal information about the client’s economy and personal qualities, meaning it has an important part in the evaluation process. Literature implies that having a good relationship with the bank will probably be of good help for the company (Funered, 1994). With this question we want to know how important this relationship is in consideration to applying for a loan and the removal of the audit obligation, especially if the company is a former client to the bank but has decided to have unaudited information. The case might be that auditing is just one of several components rather than the popular belief of being the most important one. This question will possibly give us an answer to whether or not there might be other components that are of more relevance for the banks in their credit rating processes. The validity increases since having a good relationship is one component that theories explain as being important in banks’ credit rating systems. As for increasing the reliability, this is the last question with relevance to auditing, and we have maintained a logical red thread throughout the interview.

Question 10: Is there anything you would like to add?

This is the last question and it helps us to find out if there is anything that we have forgotten to mention during the interviews. The answer will then be taken into consideration for the next interviews, where we will modify and improve the interview questions or add questions if we feel that to be necessary.

4.3 Swedish banks

The following paragraphs explain the data collection, sample selection and operationalization for the interviews conducted with Swedish banks.
4.3.1 Why Swedish banks?

The aim of this dissertation is to apply and analyze the results derived from the interviews on the three Danish banks to Swedish banks. The background problem is that statutory audit has been removed in Denmark, and the use of auditing in Danish banks’ credit rating processes is of that reason interesting. Moreover, we are interested in exploring the thoughts and acts of the Swedish banks regarding the possible removal of the statutory for smaller companies in Sweden. This research will adopt the same research design, time horizon, strategy and method as the studies conducted on Danish banks. However, the data collection and sample selection are different and thoroughly explained in the following paragraphs. The framework of the interview guide for the Swedish banks is the findings and main points of interest from the interviews conducted in the Danish Banks, and the relationships in figure 3. The logic behind that choice is to create an understanding of the Swedish banks’ mindset regarding the removal of the statutory audit for the smaller companies.

4.3.2 Data collection and sample selection

As stated in chapter 4.1.3, the study on the Swedish banks is carried out with primary data, namely interviews. However, secondary data may indeed be important to evaluate the background of the interviews as well as provide for the foundation of the investigation on Swedish banks. Moreover, the investigation on the Swedish banks also requires publications from the government concerning the removal of the statutory audit. In addition, we need written publications such as companies’ preliminary statements regarding the statutory audit from the banks. These statements are essential in order to correctly compare the results and development for Danish banks to the current thoughts and actions of the Swedish banks.

In order to somehow ensure that the chosen Swedish banks are appropriate for this study and that the interviewees are able to answer the interview questions, we need to make some limitations. In accordance with the limitations for the Danish banks, the Swedish banks chosen must also have had operations in lending and credit rating with companies since at least the year of 2005. Furthermore, if we are able to come in contact with the same bank in Sweden as we carried out an interview with in a Danish branch of the bank, these banks will be favoured in the selection process. The sampling
method used to select these banks is snow-ball sampling (Saunders, 2009; Mason, 1996). However, even though we tried this method, we did not get in contact with any of the participating banks’ Swedish equivalents.

Instead, the sample selection used is a combination of self-selection and convenience sampling within non-probability sampling (Saunders, 2009). The use of self-selection and convenience sampling is the same for both the Danish and Swedish banks. In this research we send an e-mail to banks which fulfil the mentioned requirements, asking them to participate in our research. In addition to the requirements, the chosen banks are banks operating in Helsingborg, because of the convenient distant for us.

4.3.3 Operationalization

When constructing the interview guide for the Swedish banks, we had the possible removal of the Swedish audit obligation in mind. Therefore, we had to take into consideration that some of the questions asked during the Danish interviews, had to be excluded for the Swedish interviews. Some of the questions in the interview guide for the Danish study do not have any relevance when conducting interviews with the Swedish banks. We decided to keep questions one and two the same in the two interviews, in order to see the connections between the banks, but also since these questions help us to get a quick overview of the bank and their credit rating process. We have added a size factor to each question, to see if the use is different depending on size. This was a factor that the interviewees discussed freely during the interviews with the Danish banks. When we ask the interviewees to answer a question depending on the size of the companies, we refer to the limit values for the Swedish audit obligation; 1.5 million SEK in balance sheet total, turnover of 3 million SEK and three employees (Brännström, 2010).

The questions in the interview guide for the Swedish banks are presented below. The background information and the underlying issues were brought up by the Danish banks in the interviews and we wanted to test their validity with the Swedish banks. Therefore, since we are investigating how auditing is being used in banks’ credit rating processes, the validity will increase because of these factors being discussed in the Danish interviews with a anchoring in the empirics. The reliability will also increase, since banks aim at reducing the risk involved with granting a new loan. Therefore, it is
likely that the answers given by the Danish banks will also be given by the Swedish banks. The method used in the Danish interviews, face-to-face interviews, is used with the Swedish banks as well, to ensure that the validity and reliability remain high. Moreover, the questions are open to allow the interviewees to speak freely.

4.3.3.1 Interview questions

Question 3: *How do you use the annual report in your credit rating process? How is the use different depending on if the company is small vs. big?*

Empirics show that the annual report is used by the banks to bring out various financial ratios and models when conducting a rating of a company (Tegin, 1993). Banks tend to search for additional information from various sources when conducting ratings for big companies, while for smaller companies, there might not be additional information; thus, banks rely more on the annual report of the small companies. When asking about the relevance of the annual report in the credit rating process, we will possible see whether or not the annual report is used in the same way in the Danish banks as in the Swedish banks. Furthermore, this question, together with the next one, opens up the term of auditing and the annual report. Thus, we intend to measure importance of information in figure 3, and evaluate the banks’ use of it in the credit rating processes. Moreover, it is possible that the banks in Sweden will use the annual reports the same way. Thus, banks are interested in diminishing the risk with granting a loan, which is partly done by using annual reports in the credit rating processes, and having the annual reports audited.

Question 4: *Which role does auditing play in the credit rating process? How is the use different depending on the size of the company applying for a loan?*

One aspect that was derived from the Danish interviews, and which is mentioned before, is that the annual report is used to find different information which is of importance for the bank. Various financial ratios and models are brought out from it; therefore, the information in the annual report has to be validated in some way, in order for the bank to make a correct valuation of the company. To be able to trust the information, the audit report written by the auditor has been a way of securing this. According to FAR SRS (2006), a company can gain credibility if the information is secured by an auditor, and as we discussed in the literature chapter, accounting is used
in a way to guarantee a fair system of correct information between a company and its stakeholders (Ijiri, 1983).

Therefore, this is an interesting question to ask the Swedish banks and find out what their opinions are about this statement. It can also be connected to figure 3, in the way that auditing is a way of securing information, when the audit obligation is abolished for the smaller companies. As shown in figure 3, the auditor and the accounting assessment are the components which become interesting to evaluate when the statutory audit is removed for the smallest companies. Thus, this question measures banks’ use of auditing when the auditor and the accounting assessment are eligible.

The validity increases since it is important to explore the change of information derived from the company and how the banks evaluate this, with emphasis on statutory audit.

Question 5:  *What role does the auditor play in the credit rating process? How is the use different depending on the size of the company applying for a loan?*

Question 6: *How do you use the audit report in your credit rating process? How is the use different depending on the size of the company applying for a loan?*

As stated by Watts & Zimmerman (1990), to assure a functioning relationship between an agent and a principal, an auditor may act as a third party who ensures both parties’ interest. Recently, a major scandal in Denmark with a major audit firm has weakened the credibility of auditors in Denmark. The banks we interviewed in Denmark mention that even though the audit report is important, who signs it may not be. This might have had an impact on the way the audit report is viewed by the banks. Therefore, question five and six are interesting questions to ask, to see whether or not the Swedish banks have the same view, but also to insure the validity of the factors, audit report and the relationship between banks and auditors.

Moreover, since banks are interested in reducing their risk, they evaluate all various types of information, as well as the remarks made by the auditor in the audit report. It is of interest for us to see how banks use the audit report in their evaluations. For that reason, we connect the audit report with figure 3 in terms of the information flow from the company to the auditor, and further to the bank. In figure 3, the information from the auditor to the bank is a vital step, but after the abolishment of the statutory audit,
this step will be electable. Moreover, it is of importance to investigate this step in figure 3 by asking these questions, and hopefully increase both the validity and reliability of the study by finding the connection between these two aspects.

Question 7: How did you and your bank react when the discussion started regarding the removal of the statutory audit for smallest companies in Sweden?

Our literature review shows that credit rating processes are used by banks in order to try and reduce the risk of lending out money to companies (Tegin, 1993; Strenger, Hallin & Sanden, 2008). Therefore, we are interested in finding out the banks’ general opinions and thoughts about auditing, since the importance of it is clearly stated in the empirics. Furthermore, in the interviews with the Danish banks, the interviewees were rather ambivalent regarding the statutory audit and the importance of the audit obligation. Perhaps the banks do not realize the importance of auditing but it is more or less of practice that auditing is used. When asking this question, the aim is to know the reaction of the banks and to try and connect it to the following question. The validity will at the same time increase since this is a very up-to-date topic since the Swedish statutory audit will be abolished the 1st of November 2010. The question is also connected to the reaction the banks in Denmark had towards the removal of the audit obligation, and the reality of what has happened since then.

Question 8: What kinds of actions/measurements are you taking right now regarding the possible removal of the statutory audit?

The aim of this study is also to connect the results from the interviews with the Danish banks, with the Swedish banks, and their measurements taken towards the removal of the audit obligation. It is interesting to see how the banks in Sweden are planning to act towards the abolishment of the audit obligation. Since the limit values in Sweden affect more companies than in Denmark (Brännström, 2010), perhaps there will be more significant changes to the banks’ credit rating processes. This question will possibly help us in the understanding on which types of components the banks are willing to change and which they are not. Therefore, the aim of this question is to realize different precautions planed by the Swedish banks and to compare them to the ones taken by the Danish banks.
Question 9: *Svenska Bankföreningen stands behind the removal of the audit obligation. However, they state that banks appreciate auditors and that auditors contribute to the creditworthiness of companies. What is your opinion about it?*

Svenska Bankföreningen is an organization which comprises the banks interviewed in this study along with many others. Since the organization stands behind the removal of the Swedish statutory audit for the smallest companies because of economical reasons, we feel the need to ask the banks if they agree. As mentioned before, we want to find out if the banks trust auditors; therefore, it is vital to once again make the banks face the issue of creditworthiness. However, it is important to mention that this statement of Svenska Bankföreningen concerns the first proposal of the removal of the statutory audit, which means higher limit values (Svenska Bankföreningen, 2008).

Question 10: *Is there anything you would like to add?*

This is the last question and it helps us to find out if there is anything that we have forgotten to mention during the interviews. The answer will then be taken into consideration for the next interview, where we will modify and improve the interview questions or add questions if we feel that to be necessary.

### 4.4 Reliability

Reliability is stated by Kvale (1996) as the consistency of the research findings, and by Saunders (2009) as the consistency of the data collection methods and analysis process. In order for a research to be reliable, the findings of a research should be stable over time and not be depending on the researchers or methods used (Miles & Huberman, 1994). Three questions may be asked in terms of ensuring the reliability of a research: “(1) will the measures yield the same results on other occasions? (2) will similar observations be reached by other observers? and (3) is there transparency in how sense was made from raw data?” (Saunders, 2009 p. 156). In addition, the reliability of a research is depending both on the methods used and on the persons gathering the information. A critical point of view is normally adopted in evaluating the researchers since they are the persons observing, interviewing and analysing the findings (Miles & Huberman, 1994).
We are interviewing banks in Denmark at first to insure the reliability of the study, this because the audit obligation has been removed there and the banks have already gone though this change. We will also be able to test the different factors that are important in the credit rating process, which were brought up for discussion in the literature review, by asking them about the changes after the removal and then trying to apply them to the banks in Sweden. In addition, the reliability increases if the interviews are interpreted without drawing any conclusions while transcribing them. This can be achieved by tape-recording the interviews, writing the transcripts precisely without excluding anything and consistently using quotations from the interviews in the analysis (Silverman, 2001). This has been taken under close consideration while conducting the interviews; therefore, the reliability increases.

To increase the reliability of this study we will answer the questions stated by Saunders (2009). First (1), our qualitative method and interview strategy allow the participants to answer freely because they are more in focus than us. That means that we have created an open interview guide based on our literature review, which aims at letting the interviewees answer the questions without any narrow frame. Although the interview has a broad frame to make sure that they answer in line with our study, we are interested in an in-depth analysis which we achieve by not restricting the participants too much.

Second (2), the sampling selections used in this dissertation are the self-selection, convenience and snow-ball selections, within non-probability sampling. These sampling methods are used subjectively by us; therefore, they are lowering the reliability of the study. Using the mentioned sampling selections means that we indeed are involved in the sampling selection process. For example, the convenience selection used in this dissertation is implying that the participants selected by us are not likely to be selected by other researchers. However, it is definitely possible that participants not chosen for this study will have the same thoughts and opinions as the participants interviewed in this research. As for the reliability, the same concerns the self-selection and the snow-ball sampling. Since our model and interview guide are highly based on our literature review, the reliability increases because they are formulated objectively. Moreover, the reliability increases since we do not aim at restricting our interviewees as stated above. In contrast, we are interested in an in-depth analysis and to get the full
picture of the interviewees’ thoughts and opinions. Therefore, other researchers are likely to draw approximately the same conclusions.

Third (3), the analysis is based on connections between the interviews and the theories used in the literature review. In order to keep a logical pattern and to develop an understanding for the connections made, quotations are used consistently.

4.5 Validity

Validity refers to the questioning whether the findings are relevant and in line with the purpose of the research and what the research indented to investigate (Saunders, 2009; Kvale, 1996). Also, the research findings and the analysis should make sense, and the findings should illustrate the reality (Miles & Huberman, 1994). In order to validate a research, falsification is one of the most commonly used methods. Moreover, the validity of a research is integrated in the researcher’s ability to investigate, question and interpreter the findings (Kvale, 1989). In other words, if the study is valid, it means that you observe, measure and identify what you say you are (Mason, 1996). According to Hammersley (1990:57 qtd in Silverman, 2001) validity is another word for “truth”. Kvale (1996) states this in other words when he argues that researchers validate their research when adopting a critical perspective towards their research and findings.

In terms of validity, it is then important that the questions we ask the participating bank representatives are correctly asked and give us answers to the gaps and questions in figure 3. The fact that we are two researchers who interview the interviewees increases the validity of the interpretation of the answers since we can have a discussing regarding the answers and make sure that we interpreted the answers equally.

A term which is of great interest for this study is construct validity. Construct validity means that the model created in this dissertation should be based on existing theories valid for the studied phenomenon. This dissertation is based upon construct validity because we created our model and interview guides based upon implications from the literature review (Bryman & Bell, 2007). The aim of this investigation is to test existing theories and to apply them to a new phenomenon. In addition, construct validity may be reached by “establishing a chain of evidence”. A chain of evidence is attained in a dissertation by adopting an objective perspective, measuring the concepts correctly and
linking the different parts of the thesis together (Yin, 2003). In order to keep a red threat in this dissertation, we created a model (figures 2 and 3) based on well-known theories. In addition, the interview guides are reflecting the models and the research question. Finally, construct validity may also be achieved by using triangulation; adopting multiple sources of confirmations such as data, evaluators, perspectives and methods (ibid.; Mathison, 1988).

4.6 Generalisability

Generalisability is the process of knowing how far the results can be generalized; meaning that the researchers may ask themselves if they can draw conclusions from the results which fit the rest of the population (Miles & Huberman, 1994). For this process it is relevant to gather a satisfactory sample size and to question if the sample can be generalized. This process is more commonly used in the quantitative research method, since the outcomes from that form of method are more easily generalized and can be applied for the entire population (Saunders, 2009). There are two ways for a study to be generalized: empirical generalized and theoretical generalized. The empirical generalization is more appropriate when using an analysis of few samples to generalize a wider population. On the other hand, the theoretical generalization allows the researchers to be more creative. The aim is not to generalize a total population based on a few samples. Instead, the purpose is to explore patterns of associations based on logic (Mason, 1996; Yin, 2003).

A criticism that is pointed at the qualitative research method is the lack to be able to be objective and to generalize the results. The qualitative research method does not aim at generalizing the outcome from the research, since a small sized sample is used in order to examine a situation and to analyze it in depth from different perspectives. The qualitative method is also difficult to imitate, because another researcher might not have access to the same subjects, and even if that is the case, the outcome might differ (Myers, 2000).

Since we do not base our study on a statistically representative population, it is not possible for us to empirically generalize the outcomes of our research. Since we adopt a qualitative research method, our aim is to understand the banks’ credit rating processes in-depth and which role auditing might have within them. Therefore, we seek at
theoretically generalize our findings. We do not seek at comparing our sampled participants. However, we are collecting as much data as possible from our interviews in order to find a logical pattern and categorize the data.
5. Empirical findings

This chapter consists of the results from our interviews and is divided into two main parts: results from the Danish banks and results from the Swedish banks. The participating banks and the interviewees will be introduced briefly, and each interview is transcribed and summarized.

5.1 Danish banks

We have interviewed three Danish banks with their main centre in Copenhagen. These banks and the persons interviewed will be presented in the following paragraphs.

The three participating Danish banks will in this paragraph be presented briefly.

5.1.1 Profile Case 1: Swedbank

Swedbank in Denmark started in 2005 as a branch of Swedbank in Sweden. The focus has been to provide facilitating financial solutions for both private persons who commute daily between Denmark and Sweden, as well as for companies operating both in Denmark and Sweden. The long term goal is to grow and develop more financial solutions, but the bank is of today a niche bank. The Swedbank Group has 670 000 company clients and 19 227 employees. The number of employees in Denmark is 24. In 2009 the turnover was 34, 8 million SEK (Swedbank, 2010a; Swedbank, 2010b; Swedbank Annual Report, 2009).

Hereafter, Swedbank will be referred to as Bank A.

5.1.2 Profile Case 2: Anonymous

This is a large Danish bank, which prefers to be anonymous in this dissertation.

Hereafter, this bank will be referred to as Bank B.

5.1.3 Profile Case 3: Danske Bank

The Danske Bank Group is today the largest bank in Denmark and one of the major banks in Scandinavia. The roots of Danske Bank go back to 1871 when Den Danske Landmandsbanken was founded. After several re-organizations, mergers and
acquisitions the bank, today called Danske Bank, was established in 2000. Danske bank’s goal is keeping the position as the number one bank in Denmark, as well as having the best local offices. In addition Danske Bank strives to have close and developed relationships with their clients. The bank has 6000 employees in Denmark and in 2009 the bank had a turnover of 59, 4 billion DKr (Danske Bank, 2010; Danske Bank Annual Report, 2009).

Hereafter, Danske Bank will be referred to as Bank C.

5.1.4 Summary of interviewees

Table 2 introduces the interviewees briefly.

Table 2. Profiles of the Danish Interviewees

<table>
<thead>
<tr>
<th>Bank</th>
<th>Name</th>
<th>Gender</th>
<th>Position</th>
<th>Time in position</th>
</tr>
</thead>
<tbody>
<tr>
<td>Swedbank (A)</td>
<td>Mr. Ringsgart</td>
<td>M</td>
<td>First Vice President</td>
<td>1 year</td>
</tr>
<tr>
<td>Anonymous (B)</td>
<td>Mr. Smith</td>
<td>M</td>
<td>Head of Credit Models</td>
<td>4 years</td>
</tr>
<tr>
<td>Anonymous (B)</td>
<td>Mr. Jones</td>
<td>M</td>
<td>Head of Credit</td>
<td>2 years</td>
</tr>
<tr>
<td>Danske Bank (C)</td>
<td>Mr. Justinussen</td>
<td>M</td>
<td>Group leader</td>
<td>15 years</td>
</tr>
<tr>
<td>Danske Bank (C)</td>
<td>Mr. Skopek Hansen</td>
<td>M</td>
<td>Chief Analyst</td>
<td>9 years</td>
</tr>
</tbody>
</table>

Mr. Jones and Mr. Smith are made-up names since these persons and the bank they are representing prefer to be anonymous.

Mr. Ringsgart is the First Vice President of Swedbank, Denmark. He is also the Head of Credit Risk Control for Russia and Ukraine and has Corporate Client responsibility in Denmark. The first impression of Mr. Ringsgart is pleasant and he has a positive charisma. We feel welcome and think that this is going to be a meeting of great help for our dissertation.

The two interviewees from bank B have the positions of Head of Credit Models and Head of Credit respectively in their bank. They have had these positions for four and two years respectively. The meeting is held in one the bank’s nice conference rooms. The interviewees are obliging and we can tell that they have much experience and knowledge in the field of credit rating.

Thomas Justinussen is the Group leader while Brian Skopek Hansen is the Chief Analyst at Danske Bank. The interview is conducted in their bank office in
Copenhagen. We are well met by the interviewees and get the impression that they are willing to participate in our investigation.

5.1.5 Bank A

Interview conducted at 10-04-29 at 11.00 with Heinrich Nyby Ringsgart, First Vice President, from Swedbank Denmark.

This bank’s corporate business division mostly consists of Danish companies over the limit values for the Danish statutory audit. This bank has its main centre in Sweden. Therefore, the clients of the bank are connected to Sweden. Usually this means that the clients have operations both in Sweden and Denmark. In the bank’s portfolio, 90 % of the companies exceed the limit values for the Danish statutory audit.

According to Mr. Ringsgart, the bank has a very friendly credit rating process. Depending on the size and structure of the company as well as the amount the companies wanting to loan, a loan may be granted either locally or at the main office in Copenhagen. The credit rating process of the bank looks different for various companies depending on the size of the companies. For the bigger companies, the credit rating is conducted with various financial models and ratios. The components of the credit rating process are not the same for all companies. Mr. Ringsgart states that the main difficulty of the credit rating process is to balance the risk with the information in the annual report. The annual report is used to get an overview of the business of the company and the financial status, as well as looking at reservations such as the audit report. It is possible to get much valuable information from the annual report of big companies. Therefore, the annual report is important in the credit rating process for big companies.

An important financial ratio used is \( \frac{NIBD}{EBITA} \), meaning net interest bearing debt divided by earnings before interest tax depreciation and amortization. \( EBITA \) states how good the company is at making money in the long-run, and \( NIBD \) is an expression for the debts of the company. Mr. Ringsgart finds that \( \frac{NIBD}{EBITA} \) is more important than solidity because \( \frac{NIBD}{EBITA} \) includes the cash flow of a company. The principle is the higher ratio the higher risk. He spent much time discussing this financial ratio and illustrated the numbers and figures on the whiteboard.
The problem with the small companies is that this ratio has no importance. With small companies, the EBITA is not solid; therefore, not valid when calculating ratios. For the smaller companies, the bank instead evaluates the balance sheet, shares and solidity of a company. The bank always looks at the annual report but it is not of great importance who has signed the report. For the small companies, auditing is not very vital from a banking sector perspective. Mr. Ringsgart clearly states, for the first time in the interview, that auditing is not of great importance for smaller companies. We interpret this statement as more of a “vision” than an actual truth. By that we mean that the bank might want and think that this should be the reality; however, as the interview continues we doubt this assertion. But, as Mr. Ringsgart clearly states, it is somehow negative for companies wanting to borrow money from the bank, to have unaudited information. Furthermore, he argues that companies, from a business point of view, should want to keep their annual reports audited. We feel that it is contradictory to state that the importance of auditing is different for the companies and the bank. The question we ask ourselves is: if the value of auditing is higher than the cost for the companies, would it not be the same for the banks? If the bank feels that companies, which want to borrow money, should continue using auditors, auditing must have a certain importance for the bank.

Mr. Ringsgart states that auditing is important in the credit rating process because it is the annual report which they, as a bank, evaluate. For the smaller companies they use the method of balance score cards, which is the same as in the accounting analysis.

As for Swedbank’s reaction after the decision to remove the audit obligation for the smaller companies in Denmark, they turned to their lawyers and asked them which the possible consequences could be. Mr. Ringsgart says that the consequence for Swedbank was that, after the removal of the statutory audit for the smallest companies, there is less information to review for these smaller companies. In other words, the process between the smallest companies and the bank would look slightly different after the removal.

The transactions of the company are a good way of starting the process, meaning that the company can open an account with the bank in order for the bank to evaluate their cash flow. By doing this the bank can see if there is any need to set up a credit rating
process in the central unit or if they simply can lend the money by a decision at a local unit.

Another thing Mr. Ringsgart talks about is the importance of understanding the company and the purpose of the company. When looking at small companies, the bank also tries to review the person/persons behind the company. For the small companies, cash flow is not typically solid; therefore, the bank cannot make and review a cash flow directly from them. Cash flow can also be used indirectly by reviewing contracts and transactions on the company’s account. Mr. Ringsgart does not think that the consequences of the removal of the statutory will be significant. Furthermore, he believes that in a long run the consequences would not be important, but in the short run the bank had to adapt. We get the impression that he does not think or want the consequences to be major, but throughout the interview it seems that he anyhow, realises that some adaptations had to be made.

Mr. Ringsgart continues by saying that if the companies want to borrow money from them, the companies have to have audited annual reports. He argues that it is expensive for the smaller companies to keep their auditors, but that the value exceeds the cost. If a company decides not to use an auditor, the bank will most definitely ask why. He states that the credit rating process in his bank has not changed significantly after the removal of the statutory audit and will not either. As we said before, it is somewhat conflicting of Mr. Ringsgart to say that the importance of auditing is great for the small companies when applying for loans, but not that significant for the bank.

Even though the importance of auditing is not very great for the bank, they do demand more securities or take a higher price for companies without audited information. When answering the question regarding the importance of an annual report being audited or not, he says that the bank finds it more important to know why a certain company chooses to use an auditor or not. A company might be struggling financially if it suddenly chooses not to use an auditor. Small companies are often different financially depending on for example it the company is a starter-upper, a one-man business, small or unsecure.

Another thing Mr. Ringsgart talks about is the fact that the bank’s credit rating process has not changed after the removal, and that auditing is a parameter along with other
parameters that are being used to evaluate a company. Swedbank’s business size and magnitude of the expected impact has – as for today– not justified any changes in the credit process. An important issue that is brought up for discussion is the fact that a good relationship with their clients is very important for Swedbank. This since they consider themselves as being a relationship bank with emphasis on making long term partnerships with their clients. Mr. Ringsgart tells us that there might be some kind of logic to why certain companies choose them as their bank, stating that if a company chooses Swedbank as their bank, in the competitions with other banks, they are willing to take the risk involved. He goes on saying that, since the credit rating process is based upon auditing, this is important for the bank.

Mr. Ringsgart explains that some financial ratios that are based on historical numbers and events, and that these ratios cannot be applied on a newly started company because these financial ratios are going to be bad. He also states that the same goes for the relationship between a company and a bank. This means that the best way for the bank to get a full understanding of a company is to follow their current accounts and get to know the person/persons behind the company.

He ends by saying that even though an auditor has signed the annual report or not, the bank still wants to know the history of the company. But in a matter of change, if the company goes from having an auditor to not having an auditor, Swedbank will want to know the background of this change. If there is no logical explanation to this change, it will be an increased risk for the bank.

On an end note, the interviewee states that it is the reason why a company uses/not uses auditing that is important, rather than if the annual report is signed or not.

5.1.6 Bank B
Interview conducted at 10-04-29 at 12.00 with a Danish bank centred in Copenhagen. The two persons being interviewed and this bank prefer to be anonymous in this dissertation.

The credit rating process is conducted in the credit department of this bank, and this process looks almost the same as the process for lending out new money. The interview begins with a brief introduction of the interviewees and the bank. The banking unit is
the unit where the account managers take care of the relationships with the clients. The account managers make credit ratings based upon the information available about the customers. Then they send these ratings to the credit department for approval. The credit rating process is mainly conducted with the help of four financial ratios; liquidity, profitability, solidity and EBITA. EBITA means earnings before interest, tax, depreciation and amortization. Moreover, the bank uses qualitative measurements such as quality, management, age of the company and refinancing opportunities. The ratios are calculated from information in the annual report, whereas the qualitative measurements are more evaluating and subjective. The bank decides upon a score between one and seven for each evaluation factor, where the managers of the bank have to argue for their choice of scores. These scores are updates at least once a year or when they receive new information and more often if the scores are bad.

Additionally, there are five factors which are independent of the other measurements. These are the audit report, previous mistreatment, if the company is stock-listed, the age of the company and other signs of danger. These measurements are evaluated and answered with a yes or a no. The quantitative measurements are weighted 55 % and the qualitative measurements are weighted 45 % in the credit rating process. The total rating scales from one to twelve, and the independent premiers are included in the final score. The interviewees state that it is hard to point at one or several specific factors that are most important in the credit rating process. However, they agree upon the fact that the cash flow and solvency are very important. Furthermore, a review of the annual report should, according to the bank, never be replaced by common sense. The bank has been thinking of adding a measurement which evaluates the size of the company, but as for today they have not come up with a factor which is good enough to determine the size of the company.

The bank’s portfolio mainly consists of companies which exceed the limit values for the Danish statutory audit. However, they do have some smaller companies which they granted loans to for four or five years ago. Therefore, the bank has some smaller companies, but these companies are not a part of the core segment of the bank. The interviewees say that the bank sometimes gets small and newly-established companies which do not have financial account. The credit rating process is conducted without the financial measurement if the company is small, and it is then totally based upon the qualitative and the independent factors. One of the interviewees points out that the bank
always demands audited annual reports and information from all companies if there is a risk involved for the bank. If the bank deals with a small company with unaudited information, the bank will not use this information in the actual rating model. Instead, that information will be used as additionally and general information about the company. Following this discussing, we interpret the interviewee’s statements as auditing having an important role in the credit rating process. With this said, this bank is in a position where they are able to demand audited annual report from most of its clients because their portfolio mainly consists of big- and medium sized companies.

When the discussion regarding the possible removal of the audit obligation started, the interviewees and the bank had an internal discussion about the possible consequences and adaptations. The interviewees remark on that if the bank is exposed to a high risk, they will demand audited annual reports. They also state that audited information indeed is important. However, they say that it also is important to know the customers and have good relationships with them. The importance of an audited annual report is not significant if the bank has known the company for a long time and if the company has handled its amortization and interest payment excellent.

The interviewees conclude by stating that they and the bank for sure would have another opinion if the limit values were higher for the Danish statutory audit. Also, the audit report is very important for the bank and they always check if the auditor has made any remarks or reservations. Since the banks’ models are based upon the information given in the annual reports, the interviewees mean that it indeed would be a problem if the information was unaudited. Since the bank is not very affected by the removal of the statutory audit, we assume that they mean that they would have another opinion if the limit values affected their portfolio more. However, by saying this, they indirectly state that auditing and secured information indeed is important for them.

5.1.7 Bank C

Interview conducted at 10-04-03 at 10.30 with Thomas Justinussen, Group leader, and Brian Skopek Hansen, Chief Analyst, from Danske Bank.

Danske Bank has a big variety of companies in their portfolio, meaning that they have small, medium sized and big companies; therefore, the removal of the statutory audit for the smaller companies has had an influence on them. The interviewees say that
companies in their portfolio are rated once a year or whenever new information is received. They continue on telling us that the credit rating process is based on financial ratios which are a big part of the credit rating process. These are especially used on the smaller companies because the bank needs to evaluate their daily operations and if they are able to pay back given loans.

Danske Bank uses market notices or other types of information for the evaluation of the bigger companies. For the smaller companies, they rely more on the annual reports, which are received either from the companies themselves or via the Business and credit information agency. From the annual reports, financial analyses are conducted and the company is rated based on those analyses. Other factors that are of importance are some qualitative components such as a good relationship with the client and if the company can be trusted or not. What Danske Bank also takes under consideration is what type of industry the company operates in. One of the interviewees states that for the stable industries the historical numbers says everything, but for the cyclical industries they need to find other information which is more relevant and trustworthy. Other components used are cash flow and liquidity which are, as every other financial ratio, taken from the annual report. In the end, Danske Bank is interested in finding out whether or not a company can pay back given loan and the interest rate.

Danske Bank finds auditing important in their credit rating process because of two arguments. Both of the interviewees state that the auditor’s signature of the annual report is important, since the bank at least will know that the accounts then are trustworthy. The same goes for if there is anything wrong or suspicious with the annual report, the auditor is obliged to include those notes in the report. They continue on saying that even though auditing is important, they do not rely totally on it. However, they do point out that the audit report is important because the auditor determines if the annual report is clean or not.

The main difference in the bank’s credit rating process today, compared to the one before the removal of the statutory audit, is that the bank is exposed to a higher risk. Furthermore, they state that the bank is more careful when handling smaller companies without audited annual reports. A factor which is of more importance than the actual removal of the statutory audit is the fact that the demands for the smaller companies
have become lighter. Moreover, another issue that was discussed was that it is harder to evaluate the financial analyses with less trustworthy information.

Danske Bank protested against the removal of the audit obligation in 2005 and 2006, since they thought that the timing was bad because of the financial crisis. The lack of trustworthy information when the statutory audit was abolished and the timing with the financial crises were the reasons to why they opposed the removal of the statutory audit. In order to protest, Danske Bank turned to their trade association and to politicians.

The bank’s credit rating process has not changed since the removal, but there is a difference if the annual report is audited or not. The interviewees say that the importance sometimes depends on the annual report being audit or not, and sometimes on the auditor, if he/she can be trusted or not. They also talk about the importance an audited annual report has for a new client when applying for a loan from Danske Bank. Furthermore, they say that if they already know the client, this would be of less importance.

The interviewees from Danske Bank points out that in a financial crisis there is always a balance between what other banks require and what they should require from the companies, because there is competition from the other banks about the companies. They also go on saying that they sometimes want to demand an audited annual report but might lose the client to another bank on the basis of that requirement. If the client is a new company, the bank wants to see an audited annual report. Another point that the interviewees bring up is that during the credit rating process for this new client, the bank tends to focus more on historical annual reports and financial ratios. Furthermore, they state that it is easier to set demands and requirements on a company if it is a new client. The aim of this is to see if the company does fine on a day-to-day basis.

If a company has a good relationship with the bank, the audited annual report matters less, since the bank most certainly has collected data and knowledge of this client. They also say that auditing is not crucial if the client has handled its accounts and economics totally perfect. The interviewees do not see it as a warning sign if a company goes from using an auditor to not using one. They think that there is no special value to why companies start excluding an auditor, since the smaller companies are allowed to decide if they need an auditor or not. Furthermore, they continue on saying that if the bank for
some reason is suspicious against a client who suddenly goes from using an auditor to not using an auditor; this will of course put the company in a bad light from the bank’s side.

On a scale from one to ten, the interviewees rate the importance of auditing in their credit rating process as a six.

As a closing remark the interviewees say that the major problem for their bank is that fact that the information demands for smaller companies have become lighter. This is according to them a bigger problem than the actual removal of the statutory audit for the same companies. Even though the bank does not like the removal of the statutory audit, they still have to accept and adjust to it.

Overall this bank is clear about its opinions regarding the importance of auditing in its credit rating process. They state several times that auditing is important and they would like to demand audit annual reports from all clients.

5.2 Swedish Banks

We have interviewed two Swedish banks in Helsingborg. These banks and the persons interviewed will be presented in the following paragraphs.

The two participating Swedish banks will in this paragraph be presented briefly.

5.2.1 Profile Case 4: SEB

SEB (Skandinaviska Enskilda Banken) was founded in 1865 as the first private bank in Sweden. SEB has offices all over the world, and the goal of the bank is to be the leading bank in Scandinavia within the segment of companies and asset management. In the long run, the bank strives after serving its customers with various bank services. SEB is, with its 20 000 employees, one of the leading banks in Northern Europe. The bank’s turnover was 44 213 million SEK in 2009, and the bank has 400 000 small- and medium sized companies (SEB, 2010; SEB Annual Report, 2009).

Hereafter, SEB will be referred to as Bank D.
5.2.2 Profile Case 5: Handelsbanken

Stockholm’s Handelsbank was first established the 1\textsuperscript{st} of July in 1871. Handelsbanken considers itself as being a universal bank meaning it aims to deliver services to its clients in all areas of banking. One of their goals is to have higher profitability than the competitors. In 2009, Handelsbanken was rewarded ”The Bank of the Year” and has a strong position in the Swedish banking sector, with 461 offices in Sweden. Handelsbanken had a turnover of 62 000 million SEK in 2009 and has 7 500 employees in Sweden (Handelsbanken, 2010; Handelsbanken Annual Report, 2009).

Hereafter, Handelsbanken will be referred to as Bank E.

5.2.3 Summary of interviewees

Table 3. Profiles of the Swedish Interviewees

<table>
<thead>
<tr>
<th>Bank</th>
<th>Name</th>
<th>Gender</th>
<th>Position</th>
<th>Time in position</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEB (D)</td>
<td>Mr. Persson</td>
<td>M</td>
<td>Head of Office</td>
<td>5 years</td>
</tr>
<tr>
<td>Handelsbanken (E)</td>
<td>Mr. Segergren</td>
<td>M</td>
<td>Company Advisor</td>
<td>6 years</td>
</tr>
</tbody>
</table>

Christer Persson is the Head of Office Helsingborg Råå, SEB. The interview is conducted in their bank office in Helsingborg. We have the interview in a small conference room, and Mr. Persson seems interested in our dissertation and he is willing to help us. He gives well-developed answers and we feel that we are privileged to use his knowledge in our dissertation.

Mr. Segergren is the Company Advisor for Handelsbanken office in Helsingborg. He is in charge of customer relationships with the companies in this office. Mr. Segergren seemed friendly and he was very helpful.

5.2.4 Case D

Interview conducted at 10-05-18 at 13.30 with Christer Persson, Head of Office Helsingborg Råå, from SEB.

The portfolio of SEB consists of a wide range of companies from the smallest self-employed companies to medium sized- and big companies. Mr. Persson clearly states that the credit rating process is somewhat subjective, and therefore; it is always conducted by at least two persons. The annual report is a vital part of the credit rating
process. From the annual report, numbers needed for the cash flow are derived. In order to determine the strength of a company, various financial ratios such as liquidity and solidity are calculated. Mr. Persson states that auditing is vital since it is a certain receipt which says that everything is in order. However, he also points out that auditing only is a component in the credit rating process out of several others.

In addition, the importance of auditing is depending on if a company is small or big because of the fact that there is more accessible information for big companies. For the big companies, the bank may get information in various other ways. Mr. Persson says that the bank has a good relationship with the major audit firms since they are depending on each other. Auditing is a quality stamp saying that the accounts are trustworthy, and therefore; auditing is very important in the credit rating process. The importance is great for both small and big companies since the bank needs to assure itself that it can trust the accounts.

To be an auditor is regarded as a quality stamp; therefore, the bank does not have any reason to not trust the auditors. They assume that annual reports, which are signed by auditors, are audited correctly. Moreover, the auditors are often experienced and the bank usually has a developed dialog with the major audit firms. We think that it is interesting that Mr. Persson and his bank trust auditors. As we understood from other interviews and from reading the literature, to be able to trust auditors is vital. Of that reason and because auditing is very important for this bank, it is crucial to understand why Mr. Persson trusts auditors blindly. One assumption of ours is that it is easy for the bank to trust their auditors because the bank only uses auditors from major audit firms.

Furthermore, the two things which are of great interest regarding the audit report is who signed it and if there are any remarks made by the auditor. Mr. Persson states that audit reports usually look the same, but it is still important to evaluate possible deviation. If there is any deviation, Mr. Persson argues that the bank needs to know the underlying reason. He goes on by saying that it is easy to access good information about both small and big companies. The information is very transparent compared to the available information in Denmark.

Furthermore, he argues that banks in general have discussed the matter of the audit obligation in terms of what is to happen. He says that the bank needs to develop other
ways of evaluation the trustworthiness of the companies if the audit obligation is removed, and he assures that they will manage that.

The first though which crossed Mr. Persson’s mind when he heard about the possible removal of the audit obligation for the small companies, was how that is going to work. If the audit obligation is removed, the bank will have to rethink its credit rating systems since they are based upon the fact that all companies have audited annual reports. However, he understands that the use of an auditor is very expensive and sometimes unnecessary for the smallest companies. The problem though, is the fact that the bank still has the need to assure the quality of the information involved. He argues that a possible solution might be to handle these companies manually. Furthermore, the persons responsible for the credit rating systems in the bank have begun their work with modifying the systems and evaluation the possible consequences.

In addition, Mr. Persson feels that the document from the Svenska Bankföreningen regarding the bill of the audit obligation is contradictory because the association stands behind the audit obligation, but are at the same the arguing that auditors are important for the creditworthiness of companies. He argues that he do not doubt that the bank will find other ways to evaluate the quality of companies’ information if the audit obligation is removed. However, the risk of the bank will increase when dealing with small companies without audited information. We interpret Mr. Persson as being very honesty regarding the removal of the audit obligation and the possible consequences which are to come. He does understand the reasons for the removal and it seems that he understands that the removal is necessary for the smaller companies and for the adaptation towards other European countries.

5.2.5 Case E

Interview conducted at 10-05-18 at 12.00 with Rikard Segergren, Company Advisor, from Handelsbanken.

Handelsbanken has a portfolio consisting of small to medium sized companies. However, this office in Helsingborg mainly has a portfolio that consists of medium to large companies. Mr. Segergren says that the two main components in their credit rating process are the evaluation of the persons behind the company and the company’s economical situation. Furthermore, they review the potential of the company, the future
outlook and the type of industry the company is active in. In other words, the bank reviews components that give them an understanding of the company.

Mr. Segergren states that the bank uses financial ratios in its credit rating process and compares these to other companies in the industry, to have an opinion about what is fair. However, the bank does not have a scoring model, saying if you want to be a client with Handelsbanken you have to have a solidity of for example 3.5%. One possibility to why the bank does not have a scoring model could be that this is a part of the credit rating process which they have unofficially. Moreover, one reason for this could be that the bank may want to adapt their process to each client, then having one scoring model for every company applying for a loan. Therefore, we interpreted this as the bank may have a scoring model used internally and do not want to expose it publicly.

Mr. Segergren says that the bank also uses the annual report in their rating process and continues on saying that the annual report is their main source of information about the client. Therefore, it is the most important component in their process. This is an interesting statement since all banks say that they use the annual report as their main source of information about clients.

He goes on by pointing out that the difference between small and large companies when it comes to the annual report is the information base. From the larger companies, the bank receives more information in the annual report, than from the smaller companies. In this case, it is more important to talk to the person behind the company and get a better understanding of the company this way. Furthermore, the interviewee explains that auditing is important in the credit rating process; therefore, since the auditor gives the annual report a quality stamp, as far as the auditor can judge, the numbers are correct. The same is concerned the audit report. Mr. Segergren states that he always reads the audit report in the case of there being remarks about the company. He says that if there are remarks about the company, the client will not be turned down; however, warning signs will arise that will be taken under consideration.

When asked the question about the reaction of the bank concerning the removal of the audit obligation, Mr. Segergren argues that the bank will possibly continue asking for validated information. However, he then states that companies not wanting to borrow money may not have any benefits from having their information validated. This
statement proves that he understands the reasons for the removal statutory audit for the companies affected by it.

In conclusion, Mr. Segergren says that at the moment the office is not taking any precautions against the removal, stating that the bank wants to see what happens and follow the development. However, the head office in Stockholm may be planning towards the removal and how it will affect the bank in general.

5.3 Summary Danish banks

The overall impression from the interviews with the Danish banks is that they argue that auditing is important in their credit rating processes. The banks say that the primary information source is the annual report, and that all financial ratios are calculated with numbers derived from the annual report. Moreover, an important component to secure this information is to have it reviewed by an auditor. However, one bank states that it is easy to become an auditor in Denmark and all of the interviewed banks argue that there are audit firms they trust and other they are more suspicious of.

One aspect that differs between the banks is the consequences of the statutory audit, meaning that a few of the Danish banks have had bigger impacts. As shown in figure 3, the information influences the risk, and when the information is unaudited the risk becomes more emphasized, which corresponds with our results.

According to the interviewed banks, the central part of the credit rating process is to determine whether or not a company is able to pay back the loan. In order to evaluate a company’s solvency, the banks review the cash flow of the company; therefore, it is an advantage if the company opens an account with the bank.

The Danish banks point out that knowing their customers is the most vital factor in the credit rating processes; the importance of customer relationships is even greater than having audited annual reports. All the interviewed banks discussed a particular scenario: if a company has unaudited annual reports but is a well-known and appreciated client, the well-developed relationship weights more than the unaudited annual report.
5.4 Summary Swedish banks

From the interviews we understood that banks are prepared for the removal of the statutory audit, meaning that they realize that it is going to be removed sooner or later. Even though they appreciate auditing, they are convinced that they are going to handle the consequences, and develop a modified credit rating process for the companies without audited information.

As with the Danish banks, the Swedish banks state that auditing is important in the credit rating processes because the financial ratios are calculated based upon the annual report. If the annual report is audited, the information is more valid.

However, there are different views regarding the trustworthiness of auditors. One bank argues that some auditors are trustworthy and others less, whereas the other bank says that they generally trust auditors. The banks use the audit report in order to evaluate possible remarks made by the auditor.

Both banks have not made any drastic modifications or preparatory works. Their attitudes towards the removal of the audit obligation are somewhat relaxed, meaning that they plan to act as “second-movers” and adopt a “wait-and-see” perspective.
6. Analysis

The aim of this chapter is to discuss and analyze the empirical findings from the previous chapter. Firstly, an overview of chosen factors from the interviews will be presented. Then, the banks and the factors will be analyzed separately. Lastly, comparisons among the Danish and the Swedish banks will be made respectively, as well as comparisons between the Danish banks and the Swedish banks.

6.1 Introduction

In order to analyze the findings correctly certain factors are chosen from figure 3 in chapter 3.5, which is based upon the literature review. These factors are: Information, Financial ratios, Customer relationship and Risk. In addition, two factors were detected in the interviews; Audit report and Trustworthiness of auditor. The factors are presented briefly in table 4.

Table 4. Factors in analysis

<table>
<thead>
<tr>
<th>Factors</th>
<th>Why?</th>
</tr>
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<tbody>
<tr>
<td>Factors from literature review:</td>
<td></td>
</tr>
<tr>
<td>Information</td>
<td>Central part in both credit rating process and figure 3</td>
</tr>
<tr>
<td>Financial ratios</td>
<td>Credit rating is partly based on financial ratios</td>
</tr>
<tr>
<td>Customer relationships</td>
<td>A qualitative factor stated primarily in the Stakeholder Model</td>
</tr>
<tr>
<td>Risk</td>
<td>Might be more emphasized without validated information</td>
</tr>
<tr>
<td>Factors from the interviews:</td>
<td></td>
</tr>
<tr>
<td>Audit report</td>
<td>An important component in the annual report</td>
</tr>
<tr>
<td>Trustworthiness of auditor</td>
<td>Banks are suspicious against some auditors</td>
</tr>
</tbody>
</table>

6.2 Danish banks

In the following paragraphs, the empirical findings from the interviews with the Danish banks are analyzed.

6.2.1 Case A

Swedbank Denmark is a small branch of Swedbank Sweden, with a main focus on establishing long term relationships with their clients. The bank has, as stated during the interview, a friendly credit rating; moreover, according to the bank, the removal of the audit obligation happened during the financial crisis, which made the overall credit
rating more difficult. As said during the interview, “if a Danish company with solely Danish operations chooses us as their bank, in the competitions with other banks, we are willing to take the risk involved”. This can be interpreted as the bank may be struggling with getting new clients, since the bank is a niche bank that may have difficulties penetrating the Danish bank business. Swedbank’s main focus is Swedish companies which have operations in Denmark or Danish companies having operations in Sweden and this may not be a big market. Furthermore, after the financial crisis banks have had difficulties with getting new clients; therefore, since Swedbank is a niche bank, they may have faced more difficulties.

In this interview, we had the overall impression that the bank did not know where to position itself, in the matter of the removal of the statutory audit. A fact to consider could be that the bank has 10% of smaller companies, which are affected by the removal of the statutory audit, in their portfolio. Even though the bank stresses the importance of auditing in the credit rating process, in some parts of the interview the interviewee contradicts himself, when stating that auditing is of less importance for the smaller companies, seeing it from a banking point of view. Since the limit values do not affect many companies in their portfolio, Swedbank might not have noticed the change after the removal of the audit obligation. Another statement that can be connected to this is that according to the bank, auditing is important, but it differs depending on what type of company is applying for a loan. As a result, later on in the interview, when asked about the bank’s reaction to the removal of the audit obligation, the interviewee said: “I do not think that the consequences of the removal of the statutory audit will be significant”. This statement strengthens our thought that Swedbank might not have been affected by the removal. Therefore, as a summary, Swedbank has not been affected by the removal, and moreover; their credit rating process has not changed.

6.2.2 Case B

This is a successful bank, with a clear credit rating policy. They have their accounting managers, who review the client carefully before accepting the rating in the credit department. The annual report is used by the account managers in order to get as much information about the client as possible, where the information later on is used in their rating models. The credit rating models are more or less followed strictly and a client
might be turned down, if the risk involved is significant, which may be shown in the models.

An impression from the interview is that this bank is sensitive to the risk involved when granting a loan to a new client. An important aspect to the information flow that is missing for the bank is cash flow; therefore, even though the bank is somewhat thriving it could be a facade. Moreover, statements made during the interview could be fairly conflicting. It appears as if the bank wants to show off how well they are doing, but the assumption may be that the bank is struggling, as the other banks are because of the financial crisis.

In comparison with the other banks, which we interviewed, this bank’s portfolio mainly consists of companies which exceed the limit values for the Danish statutory audit. Because of that, the smaller sized companies are not a part of the core segment for this bank. An assumption is that the bank has not been affected by the removal of the statutory audit. Since the bank does not have a lot of small companies that are affected by the limit values, statements such as “we want the information to be validated”, are easy to state. The bank is in a position where they can demand auditing from their clients since they do not have to worry about losing them to other banks, as showed by the statement “Bank B is not the main bank for small companies”.

In conclusion, this is a bank not affected by the statutory audit, since their core segment does not consist of small companies. However, an impression from the interview is that the bank may be struggling in a matter of getting new clients because of the financial crises. Moreover, the bank is somewhat sensitive to the risk when granting a new loan to a client, since it rates its clients carefully and strictly.

6.2.3 Case C

The portfolio of this bank is large, and to a high degree consists of small companies which are affected by the removal of the statutory audit. Throughout the interview, it becomes more and more obvious to us that this bank is against the removal of the audit obligation. As proven in our literature review, the aim of the auditor is to secure the information involved and both parties’ interests (Watts & Zimmerman, 1990; Thomson, 2008; Ijiri, 1983; FAR SRS, 2006). The bank feels strongly that auditors fulfill these criteria because of statements such as “it is very important that an annual report is
signed by an auditor because then we at least know that the accounts are trustworthy”; “the auditor is obliged to include remarks in the report”; “the audit report is important because the auditor determines if the annual report is clean or not”; and “with less trustworthy information, it is harder to evaluate the financial analyses”.

According to the fact that this bank emphasizes audited annual reports, the bank also argues that it is “exposed to a higher risk today”. The bank is indeed clear on its opinion regarding the statutory audit: that the government should keep it. Throughout the interview, it is rather obvious that this bank has had experience from dealing with companies without audited information, and that they favour companies with audited information.

An interesting angle concerns the fact that the interviewees do not see any particular reasons, except from economical, to why small companies would choose not to use an auditor; “we do no think that there is any special value to why these companies are starting to exclude an auditor”. If the bank points out that audited annual reports are important, why do they state that “if the companies do not think that they need an auditor, they will not use one”? This shows us that the bank considers audited information to be important, but that the bank at the same time understands the underlying reasons for the companies to exclude auditors.

Moreover, an explanation to this statement may also be the fact that the bank in a sense is “lazy”. It could indeed be easier and less costly to only review companies with audited annual reports, meaning that the bank does not have to look into the company closely because the auditor has already done that. The bank clearly states that it favours audited information because auditing facilitates trustworthy information. However, by also understanding why companies would choose not to use auditors and by arguing that “nine out of ten of these companies generally choose not to use an auditor”, the interviewees are also saying that the trend in Denmark for the small companies has been to exclude their auditors. Therefore, we argue that the interviewees somehow understand the companies, but that they at the same time favour audited information. This may be connected to the Agency Theory where the stakeholders act in self-interest with the main goals being to maximize their own wealth (Eisenhardt, 1989; Fama,
1980). The bank understands the companies, but the bank does not want the statutory audit to be removed since keeping auditing is perceived as advantageous for the bank.

6.3 Swedish banks

In the following paragraphs, the empirical findings from the interviews with the Swedish banks are analyzed.

6.3.1 Case D

This bank has a credit rating system which is highly subjective and different for every client. One central factor which is discussed during the whole interview is the fact that the bank’s credit rating system is based upon audited information; audited information is vital in the credit rating process. There is no doubt regarding the importance of auditing for this bank, and quotations which emphasize this thesis are: “auditing has a major importance since it is a quality stamp saying that the accounts are trustworthy”; “auditing is very important for us”; and “auditing costs money, but we still have to assure the quality of the accounts in some way”.

When discussing the importance of auditing, the interviewee argues that it helps the bank to assure the quality of the companies’ information, as in line with the theories studied in credit rating (Watts & Zimmerman, 1990; Thomson, 2008; Ijiri, 1983; FAR SRS, 2006). In line with the argumentation that auditing secures the information in the credit rating process, the interviewer always begins the discussion by stating that auditing is important to ensure the cash flow of a company; “we want to see, on black on white, that there is a cash flow”; and “the ability to pay back the money is very important”. In order for the bank to calculate and evaluate a company’s ability to pay back given loans, Mr. Persson states that it is important to be able to trust the numbers in the annual report.

This bank is clear on the fact that secured information is important in the credit rating process. Furthermore, Mr. Persson argues that auditing is vital in order to secure the information involved; “auditing is important because it gives a receipt that everything is in order”. Even though this importance is one of the central components of the credit rating process, Mr. Persson is not worried over the future removal of the statutory. Moreover, he mentions that banks in general have access to very much information
about Swedish companies; “with the systems we have today in Sweden, it is easy to access information about companies”; “it is easy for both small and big companies”; “the information in Sweden is very transparent”; and “the information access about companies in Denmark is much lower”. We interpret this discussion in accordance to the literature on this topic; the main reason for using auditors is in a company-banking perspective to secure the information involved (Watts & Zimmerman, 1990; FAR SRS, 2006).

Thus, the bank argues that auditing is central in their credit rating process because auditing secures the information in the annual reports. This means that the bank states that the importance for the bank lies in the fact that it demands easy accessed and trustworthy information, and auditing has until now been a secure source for the bank to access this. However, since the interviewee points out that it is rather easy to access information about companies in Sweden and because the information is transparent, the bank do believe that there are other ways of ensuring the trustworthiness of the information than auditing.

6.3.2 Case E

In general, Handelsbanken is a bank with mostly small to medium sized companies in their portfolio; however, the office we interviewed had more of the medium to larger sized companies.

The interviewee states that “we do not have any scoring models that say if you want to be a client with Handelsbanken you have to have, for example, a solidity of 3.5 %”. As mentioned earlier, we interpret this as the bank might have a scoring model, which is used internally rather than to display it for the public; therefore, this can be a way of securing your credit rating process. Throughout our interviews, it is stated that the credit rating process is a sensitive component for the banks, as we understand this goes in the line with that statement as well.

When answering the question of how the annual report is used in the credit rating process, it is said that Handelsbanken uses the annual report as their main source of information, stating: “This is the major channel that we receive information from about the client”. Furthermore, the interviewee argues that there is a difference between the
use of the annual reports for the small versus the large companies, stating once again: “in our credit rating process, auditing is important. The same goes for the smaller companies”. However, earlier in the interview Mr. Segergren mentions that “you do not get all of the information in the annual report from a small company. In this case, it is more important to talk to the person behind the company, to ask other question and to get the information from that way”. This statement somewhat contradicts the statement before, meaning that auditing is important in the credit rating process for all companies; but, for the smaller ones, less information is given through the annual report and then the relationship with the owner of the company is more important.

Later on in the interview the issue of the removal of the statutory audit was discussed. Handelsbanken is taking some precautions towards the removal but is somewhat cautious towards going public with them. We understand that banks in general are used to have auditing to rely on; however, they are still waiting to see what happens after the removal. We see that banks do not want to lose clients, and are willing to change their policies to adapt to the companies, rather than turning down clients. An impression from this interview is that banks do understand the need for smaller companies to have an audit relief, as Mr. Segergren says, “there are many companies that do not need to borrow money; they might not still need to have an annual report reviewed by an auditor”.

6.4 Factors

The chosen factors are discussed and analyzed in the following paragraphs. The empirical findings and the literature provide as the foundation of the analyses.

6.4.1 Factors from Literature review

In this paragraph, the factors derived from the literature review are analyzed.

6.4.1.1 Factor 1 – Information

Table 5 summarizes the analysis of factor 1, information.
Table 5. Factor 1- Information

<table>
<thead>
<tr>
<th>Bank</th>
<th>F1 Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>&quot;The companies should want to keep using auditing if they want to borrow money&quot;</td>
</tr>
<tr>
<td>B</td>
<td>&quot;We need information validated&quot;</td>
</tr>
<tr>
<td></td>
<td>&quot;It would be a problem if we could not trust the information given&quot;</td>
</tr>
<tr>
<td></td>
<td>&quot;It would indeed be a problem if the information would be unaudited&quot;</td>
</tr>
<tr>
<td>C</td>
<td>&quot;With less trustworthy information, it is harder to evaluate the financial analyses&quot;</td>
</tr>
<tr>
<td>D</td>
<td>&quot;The information in Sweden is transparent&quot;</td>
</tr>
<tr>
<td>E</td>
<td>&quot;If we cannot trust the information in the annual report, there may be a problem&quot;</td>
</tr>
</tbody>
</table>

All of the interviewed banks agree upon the fact that validated information is central in the credit rating process; "we need information validated"; "it would be a problem if we could not trust the information given"; "if would indeed be a problem if the information would be unaudited"; "with less trustworthy information, it is harder to evaluate the financial analyses"; “the information in Sweden is very transparent”; and “if we cannot trust the information in the annual report, there may be a problem”. The information in the credit rating processes refers to the background information which banks need in order to evaluate companies, and information is indeed the central part of figure 3. Information is important in the credit rating processes because it diminishes the risk for the banks and makes it easier for banks to evaluate companies (Svensson, 2003).

When the interviewed banks discuss the matter of validated information, they always refer to the fact that the rating models and financial ratios are mainly based upon the information given in the companies’ annual reports. Furthermore, they are all arguing that there is one major difference between the evaluation of small versus big companies; that there is more accessible information for big companies, and that small companies differ more from each other than the big companies do. However, the interviewed banks in Sweden argued that, even though it is vital with validated information, auditing is not the only way to accomplish this. This fact is of great interest, and it seems like the banks have somewhat different opinions concerning the importance of secured information.
Even though they clearly state that information is central in the credit rating processes, we interpret the banks’ discussions as having different opinions of what secured information actually is. Bank A seems to have diverse opinions about auditing and information, bank B clearly states they need audited information and bank C argues that the statutory audit is very important but they are at the same time questioning the consistency of auditors.

There are two perspectives which we find interesting and necessary to examine in regard of the importance of secured information. First, the difference in size of the banks might have an impact on their thoughts about secured information. We mean that banks have different experiences and expectations of the statutory audit depending on the size and design of their portfolios. Banks with mainly big companies, such as bank B and somewhat bank A, have not experienced any drastic changes and may still get audited information. Therefore, it is likely that they consider audited information to be important, but that they at the same time are ambivalent regarding the consequences of the statutory audit. One bank with only a few small companies, bank B, argues that they demand audited information, but that this is easy for them to say since they almost solely has operations with big companies. The same bank mentions that “actually I am not sure if we know how important auditing is”. That statement shows us that this bank emphasizes auditing but is anyhow not sure of the importance of auditing.

Banks with portfolios consisting of small companies, such as bank C, are more exposed to the changes of the information after the removal of the statutory audit. Of that reason, it is possible that they talk from experience rather than expectations of possible consequences. Bank C is the only bank which in the very first part of the interview states that “the removal of the statutory audit has had an influence on us”. This means that this bank is opposed to the removal of the statutory of two reasons: the bank needs validated information (as the other banks also state), but they have also experienced the changes and are more sure on their opinions than the banks. The conclusion from this discussion is that the banks which have experienced the changes (have a major part of small companies in their portfolio) have clear opinions, but that banks which have not experienced the actual changes (banks with almost exclusively big companies in their portfolio) are more ambivalent. The possible explanation to this statement is that banks in general feel positive towards the use of auditing in order to secure the information,
but that they in reality have a hard time of determining the consequences of when auditing is removed.

Second, we understand from the interviews that there is a problem regarding the assessment of trustworthy information for small companies; the transparency which exists for bigger companies, "annual report of a big company has a very high value for us as a bank", is not a useful tool for small companies. This means that the annual report is more important in the evaluation of small companies, than in the evaluation of big companies; "we have to rely more on the annual report for the smaller companies for the evaluation of these companies". By knowing that, we also understand that the information about small companies is more valid if it is secured by an auditor. In addition, historical information is more emphasized in banks’ evaluation of small companies than in the evaluation of bigger companies. Since historical information usually is derived from old annual reports, this statement strengthens our thesis that secured information seems to be more important for banks in the evaluation of small companies.

As stated and discussed above, the banks generally have access to more trustworthy information about big companies since it is possible to access information about these companies by using other sources than only the annual report. When banks assess information about small companies, the degree of trustworthiness may not be particularly high because of the lightened information requirements. Therefore, asymmetric information arises because the companies have access to more information about them than the banks have. Since the transparency and public interest are greater for bigger companies, this is a problem mainly for the small companies. In addition, the asymmetric information is greater when the principal (the bank) only has indirect information about the agents (the companies) (Verstegen, 2001). The banks want secured information in order to reduce the asymmetric information (Thomson, 2008); therefore, the banks favour statutory audit. Following this discussion, banks have self-interests in statutory audit and realize that auditing is an advantage for them in order to access trustworthy information about small companies.

As mentioned in the literature review, one main implication in the Agency Theory is that the principal (bank) feels the need to control the agent (company) when the agent has access to more information than the principal. In addition, it is generally hard for
the principal to correctly monitor the agent (Adams, 1994; Eisenhardt, 1989). According to this, the Danish banks get ambivalent when their source for getting validated information, auditing, is removed for small companies. It is after the removal of the statutory audit harder for the banks to access the needed information; therefore, the bank has a harder to monitoring and controlling the companies. As shown in figure 3, the risk becomes greater when the banks doubt the information and the consequence might be that the trustworthiness of the companies decreases. However, it does not seem like the Swedish banks are expecting this information problem. The Swedish banks state several times that information is more easily accessed in Sweden than in for example Denmark; “the information access about companies in Denmark is much lower than in Sweden”. This statement implies that the Swedish banks are going to access trustworthy information even without the audit obligation. Because of that, the information gap between the company and the bank will not be very significant, which means that it probably not will be harder for the banks to monitor and control the companies.

In conclusion, every bank interviewed clearly state that auditing is vital in their assessment of trustworthy information. Hence, the relationship between auditing and credit rating is strong with regard to the factor of information. The analysis above implies that the importance is great because auditing is connected to the validation of information, meaning that auditing in a banking sector perspective is an “easy” way to secure the information involved. Furthermore, in order to connect this argumentation to the factor of information, auditing secures the annual report, which, according to the interviews, is the main component of the information sources for the banks. Thus, as shown in figure 3, auditing validates the information and increases the level of trustworthiness of the companies.

6.4.1.2 Factor 2 – Financial ratios

Table 6 summarizes the analysis of factor 2, financial ratios.
Table 6. Factor 2 – Financial ratios

<table>
<thead>
<tr>
<th>Bank</th>
<th>F2 Financial ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>-</td>
</tr>
<tr>
<td>B</td>
<td>&quot;The financial ratios are weighted 55 % of the total credit rating&quot;</td>
</tr>
<tr>
<td>C</td>
<td>&quot;Our credit rating process is based upon financial ratios&quot;</td>
</tr>
<tr>
<td>D</td>
<td>&quot;We calculate various ratios to determine the strength of the company&quot;</td>
</tr>
<tr>
<td>E</td>
<td>&quot;We take a look at the annual report and bring out different financial ratios&quot;</td>
</tr>
</tbody>
</table>

A factor that was discussed in the literature review is financial ratios, and the fact that banks use them in the evaluation of a company (Tegin, 1993; Svensson, 2003). Tegin (1993) says that a good prognosis about a company’s ability to survive is made through the combination of relevance and historical financial ratios. All of the banks from the interviews agree upon the importance of financial ratios, and they use financial ratios in their work, as stated by the banks: “when we make an evaluation of a company, we calculate various financial ratios”; and "our credit rating process is based upon financial ratios". This fact is not surprising to us since it is well established in the theories that financial ratios are used in banks’ credit rating systems. A problem that may arise after the removal of the statutory audit is that for the banks to be able to conduct various models, the information given in the annual report has to be validated. Moreover, it is stated in the Swedish interviews that the banks also stress the importance of the information in the annual report to be validated in order for their credit ratings to be accurate; this was a fact that was agreed upon by all banks.

Two of the Danish banks, which have small companies in their portfolios, stressed the importance of the information in the annual report to be certified by stating that “it is very important that an annual report is signed by an auditor because then we at least know that the accounts are trustworthy”. Therefore, for the banks to be able to trust their own models and rate a company in accordance with balancing the risk involved, they have to be able to trust the numbers given by the companies in the annual reports. For the bigger companies, there are different forms of information available for the banks in order to conduct their models. However, that may not be the case for smaller companies. As it is explained further on in our analysis, one Swedish bank says that “for smaller companies, there is less information”, this confirming our understanding.
that it is more difficult for banks to evaluate companies without trustworthy information, which is taken from the annual reports.

However, in our interviews with the Danish banks, there were contradictions when discussing the importance of financial ratios for the smaller companies. One bank stated that "financial ratios are important, but not very useful for the smaller companies which are excluded from the statutory audit; while another argued that "the financial ratios are a big part of the credit rating process, especially on the smaller companies. This can be analyzed and linked to the statement given above, that banks with a portfolio consisting of both smaller companies and bigger companies view the importance of financial ratios equally. Thus, if the bank’s portfolio consists of bigger companies, the relevance is diminished.

In conclusion, financial ratios are an important component in banks’ credit rating processes, both for the Danish and the Swedish banks. Our purpose was to see how auditing is used in banks’ credit rating processes, and through figure 3, we can understand that, in order for banks to be able to trust their models and credit ratings, they need audited information derived from annual reports. Moreover, auditing has been used in the way of securing the information before it is put into different models and ratings are conducted.

6.4.1.3 Factor 3 - Customer relationship

Table 7 summarizes the analysis of factor 3, customer relationship.

Table 7. Factor 3 – Customer relationship

<table>
<thead>
<tr>
<th>Bank</th>
<th>F3 Customer relationships</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>&quot;We are a relationship bank&quot;</td>
</tr>
<tr>
<td>B</td>
<td>&quot;I think a good relationship and a good knowledge about the client is always important&quot;</td>
</tr>
<tr>
<td>C</td>
<td>&quot;The relationship with a client is indeed important&quot;</td>
</tr>
<tr>
<td>D</td>
<td>&quot;It is important to evaluate if we trust the owner&quot;</td>
</tr>
<tr>
<td>E</td>
<td>&quot;To trust the client is important&quot;</td>
</tr>
</tbody>
</table>
The banks state that it is important to have developed relationships with its clients; "we are a relationship bank"; "I think a good relationship and a good knowledge about the client is always important"; and "the relationship with a client is indeed important".

The banks do not state clearly why the relationships with the clients are a vital part of the credit rating process. However, since banks are looking for a way to access trustworthy information to simplify the credit rating process (Tegin, 1993; Strenger, Hallin & Sanden, 2008), one way might be to develop relationships with its client. The banks argue that, by knowing their clients, they get access to trustworthy information. One bank states that “if we have had the client before, we probably have collected data and knowledge on the client”. The other interviewees have similar statements, and all of them argue that a good relationship is more important than an audited or unaudited annual report. The interesting part of the insight in the bank’s relationships with their clients is the use of these relationships. These banks use the relationships with their clients in order to get information about cash flow, historical payments and an overall insight in the companies and the person/persons behind it.

Following the previous discussion, it is obvious that banks emphasize the importance of having good relationships with their client. After the interviews, we interpret the importance of the relationship between a company and a bank as very high. As opposed to other financial theories, the Stakeholder Model emphasizes the mutual relationship between a company and a bank (Bruzelius & Skärvid, 2004). We did not understand the fact that a relationship a bank might have with a company is very important. In accordance to the Stakeholder Model, the emphasis for the banks is the advantages which derive from these relationships. The implication of the relationships is shifted from the Agency Theory to the Stakeholder Model, meaning that both parties can cash in on the benefits rather than assuming that the parties act out of self-interests.

However, it is vital for the company to consider and fulfill the expectations of the banks (Carroll, 1993 qtd in Varey & White, 2000); “the easy way would be to say to the company that if you want to loan money from us you have to have an audited annual report”; and “it might be good for the companies to keep them because an auditor validates the annual report and the information involved”. It is clear that the banks are positive towards auditing, and that they realize the advantage auditing has for them. From the interviewees with the Danish banks, we also understand that the banks think
that the small companies should realize the advantages which auditing might have for them in a credit rating situation. However, one of the interviewed Swedish banks state that auditing is important in a banking sector perspective, but that “companies not wanting to borrow money may not have any benefits from having their information validated”.

As a summary, having a good relationship with its clients is indeed important for the banks. The main interpretation from the previous discussion is that banks aim at getting to know their customers in order to access valid and trustworthy information. As stated before, banks seek at getting secured information (Watts & Zimmerman, 1990; FAR SRS, 2006). By using the implications in the Stakeholder Model, banks and companies both aim at developing a relationship which may benefit both parties. Because of that, the banks access more and better information by knowing their clients. The relationship between auditing and credit rating is in that sense not as significant as when discussion other factors. This means that an extended relationship between a company and a bank over bridges the problem of unaudited information in figure 3. In other words, this relationship may be another way of solving the information problem between a company and a bank: the accounting assessment.

6.4.1.4 Factor 4 – Risk

Table 8 summarizes the analysis of factor 4, risk.

Table 8. Factor 4 – Risk

<table>
<thead>
<tr>
<th>Bank</th>
<th>F4 Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>&quot;A part of the credit rating is to balance the risk with the information in the annual report&quot;&lt;br&gt;&quot;We now do demand higher prices and more securities&quot;</td>
</tr>
<tr>
<td>B</td>
<td>&quot;The main change from before the removal to today, is that we are exposed to a higher risk&quot;&lt;br&gt;&quot;If exposed to a higher risk, we will demand audited annual reports&quot;</td>
</tr>
<tr>
<td>C</td>
<td>&quot;The risk is more emphasized now&quot;</td>
</tr>
<tr>
<td>D</td>
<td>&quot;The risk becomes higher for us without the audit obligation&quot;</td>
</tr>
<tr>
<td>E</td>
<td>-</td>
</tr>
</tbody>
</table>
Throughout the interviews with the Danish banks, the importance of diminishing the risk is discussed, as one bank states: “as a bank, you live with taking a risk. A part of the credit rating is to balance this risk with the information in the annual report”. As a bank, there are different ways of securing information given by the client, and auditing has been a stable component used in the credit rating process. In our literature review, the level of uncertainty in the credit process was discussed; therefore, banks will try to reduce this risk (Tegin, 1993; Strenger, Hallin & Sanden, 2008). We interpret this as saying that auditing is a vital tool in the credit assessment process, and after the removal of the audit obligation banks will possibly demand secured financial information either way (FAR SRS, 2006).

The following statement can confirm our interpretation: “if the company goes from having an auditor to not having an auditor, we would like to know the background of this change. If there is no logical explanation there is an increased risk for us as a bank”. Moreover, the banks use the annual reports to conduct models for their ratings, but also to diminish the risk when granting a loan with auditing as a tool. After the removal of the statutory audit for the smaller companies, the step in our model that is the information flow from the auditor to the bank will be electable, meaning as we interpreted it, the risk will be significant.

Furthermore, as discussed in the Swedish interviews, these banks are also trying to diminish the risk involved with granting a loan, as stated by one of the banks: “we need to be sure that the company can pay back the loans”. Therefore, all banks are sensitive towards the risk and are interested in reducing this risk of granting a loan to a company.

After the removal of the audit obligation in Denmark, the changes have been significant for the banks dealing with smaller companies. One of the banks state that “the risk is more emphasized now”. Moreover, it is possible for the smaller companies to continue to use auditing since, according to the interviewees, it is somewhat of a quality stamp. This is more emphasized if the company applying for a loan is not a current client with the bank or has had operations with the bank before.

Since the audit obligation is to be removed during 2010 in Sweden, the Swedish banks are planning for possible consequences. The banks are taking precautions as to what will happen after the removal, even though they do not see the removal as major change
to their credit processes. One of the Swedish banks states that “we still have to assure the quality of the accounts in some way” and continues on saying that to insure that the risk is reduced “we will have to handle these companies manually”. However, the other Swedish bank says that “we think that the companies wanting to borrow money from us must have some kind of quality stamp and review that their numbers are correct”. According to these statements, banks will possibly demand audited information if the audit obligation is removed.

In conclusion, there is a risk involved in credit rating processes, which is emphasized in figure 3. This since there is a level of secured trust that has to be gained in order for banks to believe the client. According to our purpose, which aims at exploring the relationship between auditing and the banks’ credit rating processes, auditing is a tool used to validate information from a company. The risk involved in credit rating processes is indeed affecting the level of creditworthiness of companies. Since banks aim at reducing their risk, and because audited information has been a way of ensuring this, the risk and the information flows in figure 3 are connected to each other. The risk level of the information derived for a company is indeed affecting the decision and the creditworthiness of a company.

6.4.2 Factors from interviews

In this paragraph, the factors derived from the interviews are analyzed.

6.4.2.1 Factor 5 - Audit report

Table 9 summarizes the analysis of factor 5, audit report.
One of the factors derived from the interviews is the use of the audit report in the credit rating processes. All of the banks stressed the importance of it; therefore, the banks use the audit report to see whether or not there are any remarks made about the client. However, the opinions of the importance of the audit reports differ. One bank stated that “we use the auditor’s comments, it is quite important”, but others stated that “we use the audit report as a reference”. Therefore, the audit report is used in the credit rating process to detect possible remarks and devaluate whether or not there are difficulties which the company may be facing. All banks express statements such as the following: “I always read the audit report to see if there are any reservations”. Moreover, the following statement, “If a company does not want to use an auditor for the annual report, we would definitely ask the company why”, gives us the impression that it is the audit report in which the bank relies on to find out if the future of the company is faced with any struggling aspect.

Thus, there is definitely a warning sign involved if the company goes from using an auditor, to not having it anymore; as one of the Swedish banks stated: “I am not saying that the client will be denied the loan if there are any remarks in the audit report, but remarks are for sure considered”. Also, the bank continues by saying that warning signs would possible be raised in the overall evaluation. Moreover, the other Swedish bank states that “all audit reports usually look the same”, but they look for remarks made by the auditor.

In conclusion, the importance of the audit report differs from bank to bank; however, all of the banks agree upon that it is a component that is part of the overall evaluation of a company. In figure 3, we show the relevance of auditing in the overall credit rating
process of the bank, and how the information flow derived from the company has to be validated in order for the banks to have an accurate rating. As in line with the purpose, we interpret that both companies and banks have interests audit reports. Therefore, the audit report is a component used in the evaluation of a company, since the quality of the information is secured by a third part, this being the auditor.

6.4.2.2 Factor 6 - Trustworthiness of auditors

Table 10 summarizes the analysis of factor 6, trustworthiness of auditors.

*Table 10. Factor 6 – Trustworthiness of auditors*

<table>
<thead>
<tr>
<th>Bank</th>
<th>F6 Trustworthiness of auditor</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>&quot;It is easy to become an auditor; therefore, an auditor is not always a quality stamp&quot;&lt;br&gt;&quot;It is important to be able to trust the auditor&quot;</td>
</tr>
<tr>
<td>B</td>
<td>&quot;We do not rely too much on an auditor&quot;</td>
</tr>
<tr>
<td>C</td>
<td>&quot;There are audit firms which we trust and others which we are more suspicious against&quot;</td>
</tr>
<tr>
<td>D</td>
<td>&quot;We trust the auditors&quot;</td>
</tr>
<tr>
<td>E</td>
<td>&quot;There are good auditors and not so good auditors&quot;</td>
</tr>
</tbody>
</table>

The interviewed banks emphasize the importance of auditing but they are at the same time suspicious against some auditors. We predicted, in our literature review, that banks have opinions regarding auditing and the use of it in the credit rating. However, we did not include a perspective which the interviewed banks did; how much banks trust audit firms and auditors. Since this turned out to be a perspective of great importance, we feel the need to further explain and expand this issue by having “trustworthiness of auditors” as a separate factor in the analysis process. In figure 3, we included auditor as a factor which affects the level of trustworthiness. So far, this has been analyzed more in the term of auditing, because it is more convenient and because auditing is what the auditors do. This dilemma is stated by one of the interviewees; “the question is not only if the annual report is audited or not, but also whether we trust the auditor or accounting firm or not”.

When the banks were faced by questions regarding the importance of auditing and audited information, they argued that the importance in some cases is depending on
whether they are able to trust the auditors or not. Three quotes, among several others, which state this importance, are: "it is important to be able to trust the auditor"; "we do not rely too much on an auditor"; and "there are some audit firms which we trust and others which we are more suspicious against". This means that, in figure 3, the process may be different not only whether there is an auditor involved in the process or not, but also if the auditor is trustworthy or not. By adding this perspective, we get another dimension to evaluate in figure 3. This suspiciousness against auditors did of course exist before the removal of the statutory audit in Denmark, and it does probably affect banks’ use of auditing as a tool in their assessment of trustworthy information.

One reason to why Danish banks question certain auditors may be that “in Denmark it is easy to become an auditor; therefore, an auditor is not the quality stamp which some might think”. The aim of auditing is to secure the information involved in the audit process (Tegin, 1993; Strenger, Hallin & Sanden, 2008). Figure 3 implies that the risk of the banks is lower when using auditing. Even if this generally is the case, a low trustworthiness of auditors would also lower the risk. By saying this, we mean that a low trustworthiness for auditors could have the same negative outcome for the information as not using an auditor could. In contrast, a high level of trustworthiness for auditors would lower the risk and have a positive effect on the information involved in the credit rating processes.

In contrast, being in auditor in Sweden is not as easy as in Denmark. Furthermore, Swedish banks mention that “to be an auditor is a quality stamp, and therefore; we cannot judge auditors”; and “since the auditor gives the annual report a quality stamp, as far as the auditor can judge, the numbers are correct”. These statements are examples of the fact that the Swedish banks generally trust auditors and that they do not question their work performance.

As a conclusion, Danish banks tend to be more suspicious against some auditors than the Swedish banks. In the analysis above, we mention reasons such as the easiness of becoming an auditor in Denmark and the quality stamp which auditors in Sweden have. However, the relationship between auditing and credit rating would indeed be lower if a bank did not trust a certain auditor, since the auditor is the person validating the information. Indirectly, a low trustworthiness of an auditor would leave a bank with audited information which it does not trust or have any use of. Accordingly, the value
of using an auditor in figure 3 becomes lower, and the relationship between auditing and credit rating is to a high extend depending on the trustworthiness of auditors.

6.5 Summary Danish banks

The Danish banks agree upon the fact that auditing is important. However, it is clear that the banks are unsecure of the actual consequences of the removal of the Danish statutory audit. Auditing was before the removal of the statutory audit a factor in the banks’ credit rating systems which the banks could take for granted. They did not have to question the importance of auditing, and it does not seem like the interviewed banks did that either.

The banks state that auditing is very important in order to secure the information involved in the credit rating processes. However, the do not clearly mention which the consequences have been of the removal of the statutory audit. If the importance of auditing still is great, it would be logical to recognize the consequences of the removal of the statutory audit. Some banks are demanding audited annual reports from its clients and some mention that the risk is higher today than with the statutory audit.

Moreover, the banks do not want to talk openly about their use of auditing and the consequences of the removal of the statutory audit. In addition, the topic is rather sensitive and new and it seems like the banks want to keep their thoughts for themselves. We interpret the banks as not really knowing the consequences of the removal, and therefore; the banks might not be willing to share their experiences and possible adaptations because of fear of other banks taking advantage of this.

Two of the factors derived from our interviews with the Danish banks are the importance of the audit report and the trustworthiness of the auditor.

6.6 Summary Swedish banks

The Swedish banks also state that auditing is an important component in the credit rating process in order to access trustworthy information. However, the Swedish banks do not think that there will be any major consequences after the removal of the statutory audit because it is easy to get a quick overview of a company in Sweden. Even though
the banks perceive auditing as being important, they realize other ways of accessing information about a client.

The interviewed banks understand the cost auditing has for small companies and can see it as a relief for them. However, as in line with the previous discussion, from a banking point of view the banks view auditing as being important for them.

Regarding their attitudes towards the removal audit obligation for smaller companies, the Swedish banks are somewhat relaxed. They realize that the statutory audit is going to be abolished sooner or later, and want to act as second-mover. We are not really sure if this is the case, it could be more of a façade, meaning that it could be a sensitive topic. The abolishment of the audit obligation is for sure going to affect the bank somewhat, even though to which extend is unknown. Therefore, this could be a reason for them to keep possible adaptations for themselves.

6.7 Comparisons between Danish banks and Swedish banks

Auditing is a central part of the credit rating process in both countries. Danish banks say that it is more important, and somehow the “only” way to access trustworthy information, while Swedish banks see other possibilities. There is more information about companies available in Sweden, which means that it is possible to access information without using auditing.

The trustworthiness of the auditor differs between the Danish and the Swedish banks. As stated by one of the Danish banks, it is easier to become an auditor in Denmark than in Sweden. A consequence of this is that the trustworthiness of certain auditors in Denmark is low. Figure 3 implies that the use of auditing increases the trustworthiness of the information involved in the credit rating process. However, if the level of trust is low for the auditor, it does not really matter if the annual report is audited or not, since the level of trust will be low either way. Additionally, one bank mentions a recent scandal involving a well known audit firm. This scandal increases the suspiciousness regarding certain auditors. In contrast, it is more of a quality stamp to be an auditor in Sweden. Because of that it seems as the banks trust the auditors regardlessly.
The Swedish banks are sure that they are going to find other solutions to validate the information, and we think this depends on the high level of transparent information in Sweden. The Danish banks are indeed more “against” the removal of the statutory audit than the Swedish banks. However, the case might be that the Danish banks had the same thought as the Swedish banks (the Swedish banks are more “relaxed” towards statutory audit) before the removal of the statutory audit.
7. Conclusion

Our conclusions from the empirical findings are explained in this chapter. First, a brief summary of this dissertation is presented, followed with conclusions, critical remarks, contributions and propositions for future research.

7.1 Summary of dissertation

In banks’ credit rating processes, the main aim of the banks is to reduce the risk involved. In order to accomplish this, validated information through auditing has been a common tool (Tegin, 1993; Strenger, Hallin & Sanden, 2008). The Agency Theory, the Positive Accounting Theory and the Stakeholder Model are theories which emphasize the self-interest of both a bank and a company (Watts & Zimmerman, 1990; Mouck, 1992; Bruzelius & Skärvad, 2004). Along with the maximization of a company’s own utility, the assumption that a company might have access to more information than a bank, serves as the foundation for this study. Because of the fact that auditing is vital in credit rating processes, it is interesting to evaluate possible consequences when the statutory audit is removed for the smallest companies in Denmark and Sweden.

In order to explore the relationship between auditing and credit rating, the credit rating process needed a clear definition. This was performed in this dissertation by creating a model, based on information, auditing and risk. The implications in the model were derived from an extensive literature review.

Furthermore, the study was performed through face-to-face interviews on five banks; three Danish and two Swedish banks. The data was collected through primary data, and the banks were chosen through the use of convenience and self-selection sampling. The goal of the interviews was to further explain and understand the relationships in the model, and to test the implications from the theories studied.

7.2 Conclusion

The aim of this dissertation was to explore the relationship between auditing and banks’ credit rating processes. The research question was as follows: how is auditing being used as a tool for banks in the assessments of trustworthy information?

Literature has shown that banks are sensitive towards risk, (Tegin, 1993; Strenger, Hallin & Sanden, 2008) when granting a loan. There is an asymmetric information flow
derived from the company which increases the risk for the bank, meaning that the management of the company has more information about the financials than the bank. Therefore, banks are eager to diminish the risk through various models and financial ratios, which are conducted mainly from the information in the annual report. Moreover, in order to evaluate a company and conduct an accurate rating, which will decrease the risk for the bank, the information in the annual report needs to be validated.

We found a pattern which was central in both the Swedish and the Danish banks credit rating processes; auditing is being used as a tool to validate information. Also, auditing is used to facilitate the credit rating process, meaning that the process can be made “faster” and based on more information. The relationship between auditing and credit rating processes is interesting and indeed important. The banks state that the foundation of the credit rating processes is to have validated information, and auditing is their main tool of assessing this information. Another pattern that was discovered is that banks favour auditing because it facilitates the assessment of trustworthy information, since it means that the banks do not have to validate the information on their own. The information and the risk in figure 2 are very much connected to each other, meaning that a great access of information decreases the risk and vice versa. However, the component of “auditor” as shown in figure 3, depends both on whether the annual report is audited or not, and the banks’ perception of the trustworthiness of auditors.

![Diagram](https://via.placeholder.com/150)

*Figure 3. Model for accounting assessment for banks – without statutory audit*

The accounting assessment is made through an evaluation of the annual report. If the annual report is audited, the banks emphasize the information within it in the credit rating process. However, if the annual report is unaudited, the information is used
additionally with others sources of information. Because of that, both the literature and the interviews points out that banks use auditing in order to validate information. Furthermore, the role of auditing in a credit rating process is to make sure that the banks are able to use and trust the information involved which is the general pattern discovered in our study.

Additionally, a conclusion is that the information flow and the risk in figure 3 are connected to each other. The main implication of the information flow is the fact that banks seek at accessing trustworthy information as easy as possible, which is generally carried out through auditing. Hence, audited information is a way of ensuring the information flow and to, indirectly, reducing the risk involved; therefore, trustworthy information diminishes the risk. This argumentation implies that the risk is central in banks’ credit rating processes, and that auditing is used partly as a component which reduces this risk. Throughout our study, a general pattern was that banks ensure themselves by the use of auditing.

As the literature implied, banks are sensitive towards risk (Tegin, 1993; Strenger, Hallin & Sanden, 2008). A conclusion is that banks are willing to take any precautions in order to maintain a low level of risk. As mentioned, one factor which diminishes the risk is validated information. Another factor which tends to reduce the risk is a well-established relationship between a bank and a company. Thus, the customer relationship is indeed connected to the banks’ risk in credit rating processes. According to the empirical findings, if the information access is rather low, the risk tends to increase. Therefore, a pattern that was discovered through our studies is that the bank might value a relationship with a client more if the information access is low.

A pattern discovered is that banks find auditing important; however, along with other measurements in the credit rating processes, the importance of auditing diminishes. In contrast, if a bank has access to less information and an audited annual report is the main source of information, auditing becomes vital. In accordance to this, the main aim of banks is to reduce their risk and auditing is a way of accomplishing this.

The empirical data was collected through interviews with Danish and Swedish banks. The purpose was to explore the role of auditing in credit rating processes in terms of how auditing is being uses in the assessment of trustworthy information. Hence, the aim of performing the study on both Danish and Swedish banks was partly to explore
differences and similarities between the use of auditing in Denmark and Sweden. The main conclusion and general patterns derived from the interviews is that auditing is vital in the credit rating processes in both countries in order to access trustworthy information and to reduce the risk involved. However, even though the use of auditing is similar in the two countries, the importance of audited information is slightly different. As stated, audited annual reports validate the information and facilitate the credit rating processes. Hence, the central part in figure two is the accessibility of information, since the amount and trustworthiness of information affect the risk and creditworthiness of companies. The main difference between Denmark and Sweden is the level of transparent information; there is more accessible information about companies in Sweden than in Denmark.

7.3 Critical review

As mentioned by one of the interviewed banks, the removal of the statutory audit was completed in the beginning of a financial crisis. This crisis has made small companies struggling financially and has probably increased the pressure of the banks. Because of that, companies need more money and banks have lost a lot of money in the slipstreams of the crisis. The tension in the banks is high and the demand for trustworthy information might be higher in a time of crisis since the banks struggle to keep the risk of credit rating at an acceptable level.

This dissertation is based on several chosen assumptions stated in the Agency Theory, the Positive Accounting Theory and the Stakeholder. The assumption influences the framework of this study; therefore, the interview guide is based on implications such as self-interest and maximization of own utility.

Concerning the method chosen in this dissertation, we have three critical remarks to make. The first account concerns the fact that the banks received the interview guide beforehand, which let the participants think through the answers. However, preparing the interviewees this way may also affect the answers given by them. The case might be that they answered the questions in terms of what the best answers would be in their and the banks perspectives. We did not voluntarily send the questions beforehand, but since the banks posed that as a demand for taking part in the study, we did not have a choice.
The second statement is that two of the Danish banks wanted to participate with two representatives, meaning that one advisor/analyst and one manager took part in the study. The issue was that the manager tended to “control” the other representative of the bank. We interpreted the advisors/analysts to possess the knowledge, whereas the manager was the final decisions maker who decides what the advisor/analyst can say in the interview. The problem is that we are not sure if we found out all of the information or if the participants told us what the managers though was appropriate.

Finally, this discussion is in line with the third remark; if the participants told us the truth. It is possible that the participants left out some information, but it is also possible that the information that told us was false or modified. This means that we take up a sceptical attitude towards the intentions of the banks. It is indeed possible that the banks participated in this study out of helpfulness and answers the questions honestly and openly. In contrast, a critical remark is the possible fact that the banks participated in this study out of self-interest, meaning that they wanted to “market” themselves or find out what other banks think.

An additional thought is that our participants consist of three Danish banks and two Swedish banks; therefore, the purpose of this study is not to generalize, as our main view is to get a deeper understanding of the banks and their credit rating processes.

7.4 Contribution

The aim of this research was to find out how auditing is used as a tool in the banks’ credit rating systems, and we believe that our study provide further understanding in this field.

7.4.1 Theoretical contribution

The results and conclusions of this study are easy to understand; therefore, they make a good complement to the theories on the banks’ credit rating system. Our findings imply that banks aim at reducing the risk involved in the credit rating processes at all costs. A well used tool in the assessment of trustworthy information, which is a vital part in credit rating processes, is auditing. Therefore, the risk is emphasized if this part of the process is lost.

An interesting point regarding the theories is that the relationship with the client/company is important, since it helps the banks to reduce the risk. Moreover, our
results have shown that the importance of a good relationship is in line with the Stakeholder Model. Therefore, a good knowledge of the client is more prioritized than auditing; however; when a first contact is established the bank generally requires auditing in order to certify that the information given is correct. These findings describe the fact that there is asymmetric information between these relationships, as explained in the Agency Theory.

7.4.2 Practical contribution

If considering our findings, a contribution is made to the understanding of how banks in different countries work. We investigated both Swedish and Danish banks and their views on auditing. An interesting aspect is that if the information is transparent in the country, banks have different ways of securing information. Moreover, the banks will view auditing as a part of the credit rating process and not as the most important one. Therefore, this study may be viewed by the Swedish banks in order to understand the change after the audit removal in Denmark. Moreover, the Danish banks may also have an interest in our study, since it shows that the Swedish banks have different ways to validate information. Thus, the study gives banks in both countries an additional aspect to consider in their work.

Additionally, smaller companies may evaluate this study in order to get a deeper understanding of banks’ credit rating processes and the demands for auditing and validated information.

7.5 Future research

This study is conducted with a cross-sectional time horizon because of the time restrictions provided in this dissertation. Therefore, we have studied the consequences of the removal of the statutory audit in Denmark at a given time. It would be of great interest to further test these implications with a longitudinal perspective, meaning to explore the long term consequences. As stated by one of the interviewed banks, the consequences of the removal of the Danish statutory audit are probably different depending on if the issue is studied with a long term or short term perspective.

The study on Swedish banks was carried through with the aim to understand the use of auditing in their credit rating systems. Since the recent proposal concerning the removal of Swedish the statutory audit is supposed to come into force in November 2010, a
continuation of this study could be to explore the actual consequences of the removal of the Swedish statutory audit.

Another fascinating aspect to investigate further would be the importance of developing a good relationship between a bank and a company, because our results imply that banks do find this aspect important in their credit rating processes.

Lastly, the difference of information flow in the two countries is an interesting component to investigate further, since our study has shown that it differs between the two countries.
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Appendix 1: Interview guide Danish banks

Question 1: How big is your lending activity with small vs. big companies? (Definition of small company in accordance to the limit values for the Danish statutory audit)

Question 2: How is the credit rating process conducted in your bank?

Question 3: Which components of a company are important in your credit rating process? How would you rate them and compare them to each other? Which is the most important?

Question 4: Which role does auditing play in the credit rating process?

Question 5: How did you and your bank react when it was decided that the statutory audit was going to be removed for the smallest companies?

Question 6: Has the credit rating process changed after the modification of the statutory audit? How?

Question 7: Does the importance differ depending on if the annual report is certified by an auditor or not? If that is the case, in what ways does it differ?

Question 8: How does the credit rating process for a new client with no certified annual report or information look like, after the removal of the audit obligation?

Question 9: Does the importance of a certified annual report differ if you have a good relationship with the client? How?

Question 10: Is there anything you would like to add?
Appendix 2: Interview guide Swedish banks

Question 1: How big is your lending activity with small vs. big companies? (Definition of small company in accordance to the limit values for the Danish statutory audit)

Question 2: How is the credit rating process conducted in your bank?

Question 3: How do you use the annual report in your credit rating process? How is the use different depending on if the company is small vs. big?

Question 4: Which role does auditing play in the credit rating process? How is the use different depending on the size of the company applying for a loan?

Question 5: What role does the auditor play in the credit rating process? How is the use different depending on the size of the company applying for a loan?

Question 6: How do you use the audit report in your credit rating process? How is the use different depending on the size of the company applying for a loan?

Question 7: How did you and your bank react when the discussion started regarding the removal of the statutory audit for smallest companies in Sweden?

Question 8: What kinds of actions/measurements are you taking right now regarding the possible removal of the statutory audit?

Question 9: Svenska Bankföreningen stands behind the removal of the audit obligation. However, they state that banks appreciate auditors and that auditors contribute to the creditworthiness of companies. What is your opinion about it?

Question 10: Is there anything you would like to add?