Evaluation of a change in the Norwegian legislation: The effects of making audit voluntary for small firms

by

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This memorandum is a summary in English of the report "Evaluation of granting small firms an exemption from the requirement to be audited", which was handed over to the Norwegian Ministry of Finance on March 28, 2015. The report is only available in Norwegian. This memorandum contains main findings and a summary of each chapter.

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1 Introduction and background

On December 17, 2012, the Norwegian Department of Finance presented a tender offer for the project "Evaluation of granting small firms an exemption from the requirement to be audited." BI Norwegian Business School was awarded the assignment. The agreement that regulated the content of the project was entered into on April 8, 2014, with the delivery of the final report scheduled for December 31, 2014. After an agreement between the Department of Finance and BI, the project was expanded, and the date of delivery for the final report was moved to March 28, 2015. The overarching goal is that the project should give:

> "[a] broad evaluation of the rule change that from 2011 gives small limited-liability companies ("aksjeselskaper," or AS) permission to elect not to be audited. The evaluation should examine the consequences of the rule change, both positive and negative, for the companies that choose not to be audited, for other economic actors, for the tax authorities, and for society. The results of the random controls carried out by the tax authorities should be included as a source of data. In addition, the use of other data sources would be beneficial.
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> A complete evaluation of the rule change includes both positive and negative effects. The effects can be viewed in relation to the companies that choose not to be audited, the companies' owners and creditors, and other users of the companies' accounting reports, users such as employees and customers. Also, the implications for the tax authorities as well as possible implications for the revenue collected by the tax authorities should be examined. The prevention of and fighting against economic criminality is also a question in this context. In addition, the evaluation should evaluate the consequences for auditors and accountants.
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> The evaluation should analyze the effects of choosing not be audited for the accounting years 2011 and 2012. Prior accounting years, during which companies did not have the right to choose not to be audited, should be included to the extent that these years are required for the analyses." (Excerpt from the contract, chapter 0, points 1 and 2.)

This report documents the analyses that have been carried out and what the basis for our conclusions are. Only the main findings (chapter 1.2) and the summary of the chapters (chapter 1.5.3) is available in English.

2 Main results

The analyses cover primarily the period 2006 through 2012. In most chapters, the analyses are based on information the companies send the tax authorities (Skatteetaten, The Norwegian Tax Administration, NTA) and The Brønnøysund Register Center. In addition, several questionnaires were carried out. The different methods and tests that are used yield largely the same conclusions.

The most important results are as follows:

1. **The opt-out law affects many AS companies, but the fraction of the economy that became unaudited is small**. Measured in relation to the sum of operating income for all of the companies that sent their accounting statements to The Brønnøysund Register Center regardless of company type, the percentage of sales that was not audited increased from 0.17 percent in 2010 to 1.4 percent in 2012. If we look at total assets, the share of total assets that was not audited increased from 0.51 percent to 0.81 percent. For all AS companies taken together, in 2012, unaudited sales accounted for 1.5 percent of total sales, while unaudited total assets accounted for 1.1 percent of all total assets. If we look at the number of companies instead of

the sums in Norwegian kroner, 11,739 companies were not audited in 2010. In 2012, the number increased to 78,857. If we look only at AS companies, in 2012, 30 percent of such companies operated without an auditor (and all had an auditor in 2000).

2. **No negative financing effects of not being audited.** When we compare the development in interest rates and access to loans and credit over time for companies that choose not to be audited (opt-out companies) in 2011 with similar companies that choose to be audited, we find no sign that choosing not to be audited led to higher interest rates on loans or a deterioration in access to credit.

3. **Cheaper audits.** In 2010, 2011, and 2012, the years when the opt-out law came under consideration and entered into force, real price growth in audit services essentially stops. If the real price growth in audit services in 2010, 2011, and 2012 had been the same as in 2007, 2008, and 2009, companies that chose not to be audited in 2011 or 2012 would have paid 14,000 Norwegian kroner (NOK), on average, in audit fees in 2012.

4. **In 2012, net savings for those companies that opted out is around NOK 20,000 per company.** Three different methods are used to estimate the net savings for companies that choose not be audited; "net savings" denotes the savings from not paying audit fees adjusted for other effects, such as increased fees to accountants, higher interest rates on loans, a decline in wage expenses because employees use less time in communication with the auditor and planning for the audit, *etc*. The three point estimates on average net savings are NOK 19,250, NOK 19,950, and NOK 23,600. If we take into account the uncertainty in these estimates and use regression analysis, we can say that with 95 percent probability, average net savings lies between NOK 15,000 and NOK 31,600. Net savings is measured by the change in operating income for companies that choose not to be audited compared to similar companies that retain their auditor. Hence, the effects of increased purchases of non-audit services or higher fees to the accountants are accounted for. As noted in point 2 above, companies that are not audited do not have an increase in financing costs.

5. **In total, AS companies achieved net savings of NOK 1.6 billion in 2012.** This sum consists of the following components: NOK 120 million in foregone audit fees for newly established companies, NOK 780 million in foregone audit fees for companies that choose not to be audited, NOK 320 million in reduced audit fees for companies that choose to retain their auditor due to lower prices on audit services (point 3 above), NOK 90 million in reduced time use for newly established companies, and NOK 290 million in reduced time use for companies that choose not to be audited. The decline in the price of audit services in 2010-2012 affects all companies that are required to be audited, not just AS companies. The estimate of NOK 320 million in reduced audit fees in 2012 applies only to AS companies. After taking into account that all types of companies, not just AS companies, have benefited from the decline in the price of audit services, the estimated savings of NOK 1.6 billion is a level-headed estimate of total net savings for all companies.

6. **The quality of the tax returns has declined.** Companies that choose not to be audited could lose the competence of the auditor in assisting with filling out and submitting the tax returns. Several independent analyses show that the quality of the tax papers has decline. "Quality" is measured in different ways. With the help of a quality index based on detailed random controls carried out by inspectors in the NTA, analyses of automated controls of electronically filed tax returns, and a survey among tax inspectors. How quality is measured does not affect the conclusion – quality has declined. In addition, representatives from companies that choose not to be audited and from newly established companies agree: more than one-third of respondents

who do not use authorized accountants or auditors agree with the claim, "Mistakes possibly occur when we work out the annual accounting reports and tax returns, but they are not substantial or important."

7. **There is no evidence that the scope of opt-out companies' tax avoidance, insofar as they engage in tax avoidance, has increased after choosing not to be audited.** To examine whether opt-out companies, for example, keep revenue off the books or charge personal expenses to the company to a greater degree after opting out, we compare the development in measures of earnings and accruals for opt-out companies with those of similar companies that keep their auditor. We find no sign that tax avoidance has become more common among opt-out companies, with the exception of some small industries that account for 2.6 percent of all companies. Also, we analyze the impact on revenue of the random controls carried out by the tax authorities. In these inspections, the tax authorities randomly selected over 2,100 companies for controls, using a procedure developed by Statistics Norway. The inspections were comprehensive, with each inspection taking 3.5 days, on average. The goal with the inspections was mainly to examine whether the quality of the companies' bookkeeping and accounting systems changed after the opt-out law was passed. In cases where the inspectors discovered tax avoidance, however, the inspectors followed up by adjusting the tax returns. Those companies that were inspected were required to pay an additional NOK 19.9 million in taxes of various types. Opt-out companies accounted for 42.7 percent of the inspected companies but were required to pay only NOK 3.2 million (16 percent) in additional taxes. The remaining NOK 16.7 million (84 percent) was due to companies that retained their auditor. Hence, based on the random controls carried out by the tax authorities, inspecting companies that keep their auditor is profitable, whereas inspecting opt-out companies leads to a loss.

8. **The decline in the quality of the tax return applies to companies that do not use either an accountant or an auditor.** Above, we report that the results clearly indicate that the quality of the tax returns declined for opt-out companies. When these companies get help from an accountant or an auditor, however, the results show that the quality becomes roughly as good as the quality of companies that keep their auditor.

9. **Overall, we find no decline in earnings quality among the opt-out companies, but we do find indications of reduced earnings quality among the opt-out companies that have the greatest potential for earnings management.** Various measures of earnings quality are used, and these measures try to capture the financial statements' ability to reflect economic reality and the level of earnings management. The potential for earnings management is regarded as highest among opt-out firms with high levels of accounts receivable, inventory, accounts receivables and inventory lumped together, and/or high level of debt. All firms included in the analyses must have turnover and asset above 1 million NOK, and the comparison is done between opt-out candidates that have kept their auditor and to companies that have turnover above the threshold, but less than 10 million NOK.

10. **Companies rationally choose to vote down their auditor.** The analyses show that companies continue to be audited when the demand for audit services is present, with respect to either the auditor's provision of non-audit services or parties outside the business. When the company is tightly integrated with its owner's personal financial condition, the demand for audit services declines and the opt-out ratio increases, but transactions with related parties are not an important factor compared to other variables. The behavior of companies, as measured by rule compliance, change of auditors, and the company's will to comply with deadlines and agreements, has a smaller role in its decision of whether to keep the auditor. The same conclusion applies for

conflicts with the auditor, measured by remarks in the audit report. The variables that have the largest effect for the decision of whether to keep the auditor are the company's size, measured by total assets and sales; whether the company has an accountant; whether the company engages an accountant for the first time; and whether the company had purchased additional services from the auditor in prior periods. The analyses show also that the likelihood of choosing not to be audited is higher for companies that have had abnormally high audit fees and is lower for companies that have used the same auditor for many years. The importance of a long relationship with the auditor, however, is much smaller than is the importance of paying abnormally high audit fees. When we use almost 100 variables to control for differences between opt-out companies and companies that retain their auditor, we find that opt-out companies have paid 8.6 percent more in audit fees compared to similar companies that choose to retain their auditor.

11. **The use of resources by the tax authorities has increased.** The questionnaire among respondents from the tax authorities who work with the tax returns shows that 54 percent say that they use more time on the tax assessment of opt-out companies, with an average time increase of 25 minutes per company. At least one-third perceive no correlation between time use and whether the company is audited. The two most important reasons for this increased time use is that the sums reported in the tax returns are mistaken or lack information and that when the tax authorities send an inquiry to taxpayers, taxpayers do not understand what the inquiry is about.

12. **Lower requirements for share capital are more important for the desire to establish an AS company than are abolishing the law that requires small AS companies to be audited.** In 2012 and 2013, roughly 26,000 companies were established in each year. Of these companies, roughly 13,300 were established because the requirements for share capital were reduced (taking effect from January 1, 2012) and because audit became optional for the smallest AS companies (taking effect from May 1, 2011). Both trend analyses and questionnaires show that the change in the audit requirement had a smaller impact on the desire to establish AS companies than did the reduced requirements for share capital.

13. **The audit industry has managed the adjustment well, while the accounting industry has not seen unusually strong growth.** Revenue in the audit industry has remained on roughly the same level in 2010, 2011, and 2012, and while the accounting industry has grown. Profitability in the two industries is largely unchanged. Audit companies that have authorization only as an audit company have had the largest decline in revenue, but they have managed to reduce costs by amount the same amount that revenue has fallen.

At the bottom of the bathtub, you have a bucket that holds ten liters. You fill water in the bathtub so that both the bathtub and the bucket are full. When the water is completely at rest, you grab the bucket and remove both the bucket and the water the bucket contains. How long before the water is completely at rest again? This question is relevant in the context of the analyses in this report. The audit market was roughly in equilibrium until the opt-out law was introduced and before a number of new AS companies emerged because of the reduced requirements for share capital. How long before the audit market comes back to equilibrium, and will the results that hold right now persist in the new equilibrium? The response is uncertain because the analyses are done in a period when the audit market moves from one equilibrium to the next.

3 Summary of the Chapters

3.1 Summary of Chapter 2, «Audited and unaudited business activity before and after the introduction of the opt-out choice for small companies»

The goal of Chapter 2 is to put in perspective the law that allows small Norwegian limited-liability companies ("aksjeselskaper," or AS) to choose not to be audited. This chapter focuses on such questions as: How large a share of companies are eligible to choose not to be audited? How many companies have chosen to operate their business without having an auditor? How much did the share of unaudited business activity increase after the introduction of the opt-out law? In 2010, only 4.8 percent of companies that reported accounting information to The Brønnøysund Register Center were not audited. In 2012, this figure was 30.2 percent. Measured by total assets and sales, however, this increase is limited. In 2010, among all companies that reported accounting information to The Brønnøysund Register Center, companies that were not audited accounted for 0.17 percent of sales and 0.52 percent of total assets. In 2012, companies that were not audited accounted for 1.4 percent of sales and 0.81 percent of total assets. Hence, in 2012, although more than 30 percent of limited-liability companies operated without an auditor, around 99 percent of total business activity was conducted by companies that were required to have an auditor.

In 2012 and 2013, around 26,000 companies were established each year. These figures are much higher than in the previous years. Certain analyses indicate that changes in the company law that entered into force in 2012, such as reducing the requirements for share capital, have had a larger impact than has the law that lets companies opt out of being audited (the «opt-out law») in leading to the establishment of new companies. In addition, these analyses indicate that in each year in 2012 and 2013, around 13,300 new AS companies were created. Survey results, discussed in Chapter 14, confirm these numbers and suggest that the changes in the capital requirements were more important for the rate at which new businesses were established than was the change in the auditing requirements.

The rate at which sole proprietorships (referred to as ENK) and companies with unlimited liability (referred to as ANS/DA) were established declined in 2011 and 2012, but this decline was a continuation of a trend that started in 2003 and 2004. The rate of establishment for Norwegian subsidiaries of foreign companies (referred to as NUF) started to decline in 2010, implying that the law changes made establish an AS company more attractive than establishing an NUF company. The large increase in the number of newly established AS companies in 2012 and 2013, however, was not due to a conversion of NUF or ENK companies to an AS company. This issue is examined more closely in Chapter 14.

In this report, opt-out companies are distinguished from companies that were established without an auditor. An «opt-out company» denotes a company that had an auditor but, after the introduction of the opt-out law, chose to vote down its auditor, doing so formally by sending a message to The Brønnøysund Register Center. Companies that were established without an auditor are not called opt-out companies because these companies have never had an auditor that they could dismiss. In this report, companies that are established without an auditor are referred to as newly established companies without an auditor, or something similar. Among companies established in 2011, 56.3 percent have an auditor as of January 1, 2014. Among companies established on or after January 1, 2012, 31.8 percent have an auditor.

To estimate how large a percentage of companies chose not to be audited, we compare the number of companies that reported to the The Brønnøysund Register Center that they would no longer be audited to the number of companies that could have reported that they no longer would be audited. An «opt-out

candidate» denotes a company that was, in our estimation, very likely to have been eligible to choose not to be audited. This definition takes into account that certain companies likely did not choose to vote down their auditor even though they technically met the conditions to do so. As an example, a company that expects to exceed in the following year (for example, 2014) the size threshold value for opting out likely would not vote down its auditor in the current year (2013). In this case, voting down the auditor in the current year likely would not yield large cost savings for the company, given that the company would have to engage an auditor in the following year.

We identify 93,311 opt-out candidates in 2011. Of these candidates, 40.6 percent opted out by the end of 2011, while 54.3 percent opted out by the end of 2013. We exclude subsidiaries from the definition of opt-out companies. We do so because a subsidiary's parent company must have an auditor, and when the parent company must be audited, the subsidiary likely will itself choose to be audited because the auditor of the parent company must confirm the accounting information in the subsidiary. If we include subsidiaries as opt-out candidates, the percentage of opt-out candidates that opted out by the end of 2012 is 50 percent. (The reduction from 57.2 percent to 50 percent arises because subsidiaries choose not to be audited roughly half as often as are independent companies.)

We anticipate that over time, between 65 and 70 percent of the companies that are eligible to function without an auditor will choose to do so. This percentage is substantially higher than in Denmark, where roughly 38 percent of companies that are eligible to opt out have done so. The reason fewer companies in Denmark have opted out is that Danish auditors can carry out many more services for small audit clients than can auditors in Norway, services such as doing a company's accounting. Hence, companies have weaker incentives to vote down their auditors. In Finland and Sweden, 78 percent and 52 percent, respectively, of companies that are eligible to opt out have done so. In each country, to be eligible to opt out, a company must be below certain size thresholds (for example, total assets must be below some maximum amount). These size thresholds vary between countries, with Finland having the lowest such thresholds.

3.2 Summary of Chapter 3, «Economic criminality»

The auditor can play an important role in the prevention and detection of economic criminality because auditors have unique access to the company's information and knowledge about the relevant regulations. The introduction of the opt-out law lets more companies operate without being subject to the controls carried out by the auditor. This chapter discusses the areas where the opt-out law could affect economic criminality. In addition, this chapter discusses the difficulties with testing whether choosing not to be audited affects the scope of economic criminality. Such tests present large challenges. One reason is that persons engaging in criminal activity wish to conceal their activities, so that data for violations of the law are difficult to obtain. Another reason is that a share of those that operate in business have not tried to violate the law because they have had an auditor. Reliable data over the scope of violations of the law that have been considered but not carried out are presumably impossible to obtain. A third reason is that examining the effect on economic criminality of not being audited must involve a comparison of the situation before and after the opt-out law was passed, so that criminality must be examined both before and after companies choose not to be audited. The period before the opt-out law must be included, as examples from case law and the tax inspections indicate that criminality happens also with companies that do have an auditor. Hence, one cannot assume that a company operated in a legal manner up to the point at which the opt-out law was adopted.

This chapter cites a few survey results that can give indications on the frequency of economic criminality with companies with and without an auditor. Most examples relate to tax avoidance. Of special interest are the random controls executed in 2012 and 2013, where the Norwegian Tax Administration (NTA) inspected over 2,100 randomly controlled companies in accordance with a sample-selection procedure that ensured that the findings are representative (point 7 above). The inspectors responded to discovered law violations with accounting remarks, requirements to adjust the bookkeeping, and changes in the tax returns. The accounting remarks are requests to the taxpayer to repair mistakes and deficiencies in the accounting, requirements to adjust the bookkeeping are a stronger request that can be followed up with fines, and changes in the tax returns are undertaken when the inspectors uncover tax avoidance. If we look at the smallest (accounting remarks) and the most serious (changes in the tax returns) violations of the law, companies that voted down their auditor had violations that were more common but less serious. Companies that kept their auditor had more-serious violations, but these violations took place less often. As an example, the tax avoidance uncovered among companies that voted down their auditor amounted to NOK 180,405, on average, compared to NOK 1,111,636 for companies that retained their auditor. In addition, other inspections carried out by the NTA show that if companies wish to operate in an illegal way while still having an auditor, they can do so.

In addition, the chapter shows how messages of whitewashing to The Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime (Økokrim) are divided between AS companies with sales below NOK 5 million and AS companies with sales above NOK 5 million. The chapter shows also whether the messages come from an auditor, an accountant, or from another party. The overview shows that few messages concern small AS companies and that in the period 2006-2012, auditors have never given more than 26 messages of AS companies that have sales below NOK 5 million.

The chapter gives also an overview of the frequency of bankruptcy for companies of different sizes, including companies that did vote down their auditor and companies that could have voted down their auditor but did not. The point of departure for the analysis of the number of bankruptcies is that if the change in the requirement to be audited has affected the probability of bankruptcy (for example, because owners to a larger degree than before extract resources from the company, so that the company becomes bankrupt), such effects should reveal themselves in more bankruptcies by companies that vote down their auditor. The period of time is short, but based on the numbers from 2011 and 2012, the probability of bankruptcy is higher with companies that have kept their auditor than with companies that have voted down their auditor.

As of the present time, our knowledge of the connection between not having an auditor and economic criminality is limited. The chapter points at some features that can indicate which role the opt-out law could have, but for the time being, the information is too fragmented to draw any conclusions.

3.3 Summary of Chapter 4, «Characteristics of companies that opt out»

The theme for this chapter is why some companies choose to vote down their auditors while others do not. We group the explanatory factors into ten categories. *Agency conflicts* are factors that describe the potential for conflicts of interests between parties with an interest in the company. Agency conflicts are divided into two types. External agency conflicts are conflicts between the company and its creditors, employees, customers, suppliers, *etc*. Internal agency conflicts are conflicts between owners, between members of the board, or between owners, the board, and the management. *Company risk* describes risk that relates to the operation of the company. C*ompany behavior* covers the company's will and capacity

to comply with agreements, deadlines, rules, and laws. *Demand for the auditor's services* includes relations that create or reduce a company's demand for the auditor's services beyond those required by law. *Price and duration of the auditor's services* measure the audit fees paid to a company's auditor as well as how long a company has used its auditor. *Transactions with related parties* includes the loan, purchase, sale, rental, *etc*. of assets between a company and its owners or other related parties. *Socio-demographic characteristics* examine how the income, wealth, civil status, immigrant status, education level, and type of education of a company's central decision-makers affect the company's likelihood of opting out. («Central decision-makers» denotes a company's chairperson, manager, and up to the two owners with the largest voting rights.) *Family relations* examines the impact of family relations between the owners and the members of the board as well as the number of families are involved in the company. *Industry* and *region* control for differences between industries and regions, respectively, in how often companies opt out.

The first eight categories include 64 variables, while the last two include 36 variables. All variables are taken into the analyses simultaneously. Hence, we estimate the marginal effect of a concrete variable on the likelihood that a company opts out after controlling for all of the other variables. As an example, we examine the impact of having pledged collateral as a form of security after controlling for, among other factors, a company's size, debt ratio, profitability, and liquidity. These analyses include companies that were opt-out candidates in 2011 and that delivered statements of business to Altinn (a Norwegian government agency that handles electronic filings) or that sent in their annual accounting reports in 2010 and in 2011. The correlation between a company's probability of opting out and its size is non-linear: The probability of opting out increases until a company's sales comes to 1 million Norwegian kroner (NOK). Beyond this point, the probability of opting out declines. This non-linearity is managed by dividing opt-out candidates into two groups: large companies and small companies, where large companies are opt-out candidates that had in 2011 at least NOK 1 million in sales or NOK 500,000 in total assets.

The analyses show that companies make rational opt-out decisions. When the demand for an auditor is present, due to either concrete services (as measured by «Demand for the auditor's services») or demand from parties outside the business (as measured by «External agency costs»), companies are more likely to keep their auditor. When a company is tightly integrated with its owner's personal financial condition, companies are more likely to vote down their auditor. Transactions with related parties, however, are not important: When the variables are ranked by importance, the first variable that relates to related-party transactions comes in at 22nd place for large firms and 11th place for small firms. Interestingly, variables in the category «Company behavior,» which include a company's compliance with rules, changes in auditors, and the company's will to comply with deadlines and agreements, has a small effect compared to the effect of other variables. In the sample with large companies, the variable measuring the number of audit remarks in the auditor's report ranks 39th, while this variable ranks 30th among small companies. The variable measuring the number of qualifications places 13th and 24th, for large companies and small companies, respectively, but few companies (2.3 percent of the sample) receive such qualifications. The variable that measures how often a company changes auditors comes in 52nd place and 42nd place among large companies and small companies, respectively. If companies choose not to be audited because they think conflicts with the auditor lead to qualifications and reservations in the audit report, or if companies do so because changing to a different auditor would be tiresome or unpleasant, these variables likely would have a larger effect. The variables that have the strongest impact are the same among both small and large companies, but with somewhat different rankings. Size, as measured by total assets and sales, ranks 1st and 4th for large companies and 1st and 5th for small companies. Whether a company has an accountant who does the accounting or has engaged an

accountant for the first time in 2011 comes in 2nd and 3rd. The demand for additional services from the auditor is 5th for large companies and 4th for small companies. Total employees is 6th among large companies and 17th among small companies.

The probability of opting out is higher for companies that have paid abnormally high audit fees and is lower for companies that have used the same auditor over many years. Both variables are significant, but the price paid to the auditor has a far stronger impact than does the length of a company's relationship with its auditor. The research design we use allows for the impact of the size of the audit fee after taking into account a company's size, risk, complexity, region, industry, *etc*. The analyses show that opt-out candidates had audit fees of slightly over NOK 12,200 in 2010 and that these companies paid 8.6 percent more in audit fees than did similar companies that retained their auditor. The size of the audit fee comes in 6th place for large companies and 8th place for small companies with respect to the impact of the different variables on the likelihood of opting out.

3.4 Summary of Chapter 5, «Financing effects of opting out»

The theme in this chapter is whether firms had fewer options for external financing or could access such financing only on worse terms after choosing not to be audited. The point of departure is that accounting information is used as part of the basis for agreeing and pricing credit. Hence, choosing not to be audited can increase the risk that a firm's accounting information contains mistakes or is misleading. If opting out increases this risk, lenders likely will protect themselves by refusing loan applications more often or by charging a higher interest rate as a way to compensate for taking on more risk. The question in this chapter is whether opt-out companies have incurred these types of financing drawbacks. This question is addressed through empirical analyses as well as a questionnaire among a sample of banks, suppliers, and mortgage companies.

We use different ways of measuring financing effects. The best and most precise measure is the interest cost on the loan from savings banks, commercial banks, and finance enterprises, hereafter referred to as «banks». To estimate the interest rate, we use the account statements that the banks send their customers in January each year. The underlying hypothesis is that if opting out increases the risk banks face, banks will charge opt-out companies a higher risk premium compared to similar companies that choose to keep their auditor. Since the account statements we use show only the year's interest expense and the debt as of the end of the year, the estimates based on these statements could be somewhat imprecise. We have compared the level of and changes in these estimated interest rates with the company's economic development and the development in the bank's net lending margin. (The level of and changes in the estimated interest rates are different between opt-out companies and companies that kept their auditor.) Both the level of and change in these interest rates are consistent with the companies' economic development and the development in the bank's net lending margin. In addition, we execute sensitivity tests to ensure that the results are not affected by the bank's personal knowledge about the companies and the companies' owner and management, the addition or departure of companies during the sample period, and the number of periods the independent variables are moved in relation to the dependent variables. Furthermore, we carry out the analyses on a sub-sample of companies whose type of loan is held constant. In this way, we ensure that the results are not explained by a change in types of loans, such as the replacement of short-term loans with collateralized loans.

In addition to interest rates, we search for other financing effects that could result from opting out: a) an increased share of short-term debt, because issuing short-term debt instead of long-term debt lets banks exit more quickly; b) fewer new loans due to lower perceived credit quality; c) more payment remarks

because of reduced access to credit from banks; d) a change in credit time from suppliers, either because suppliers demand more immediate cash payments or because opt-out companies have reduced access to credit from the banks, so that paying suppliers on time becomes more difficult; and e) a lower frequency of switching banks, because new banks are more skeptical of opt-out companies. The interpretation of some of these alternative measures of financing effects are less clear than is the interpretation of interest rates. As an example, opt-out companies could have a lower need for new loans because they do not wish to grow as quickly as do similar companies that kept their auditor. Observing fewer loans among opt-out companies could imply that banks are more skeptical of these companies, that these companies have a lower demand for loans, or some combination of these effects. The data use opt-out candidates from 2011. We compare the situation for opt-out companies in the year(s) before and after opting out with similar companies that retained their auditor. We control for relationships that give a natural explanation for changes interest rates, such as changes in a company's risk of bankruptcy.

The results are clear: For the measures that have the clearest interpretation, we find no indication that opt-out companies have had problems obtaining external finance as a result of opting out. Interest rates did not increase, and opt-out companies did not see a rise in payment remarks or increased problems with having access to loans from banks they have not had relations with before. These findings from the empirical analyses are consistent with the impression that comes from the interview survey. This survey was done with five savings banks, five commercial banks, and seven large suppliers. The commercial banks take security by requiring collateral from the owners. Hence, for commercial banks, the quality of the accounting has a smaller role. Two of the five savings banks require audited accounting reports, and for the three savings banks that do not, the opt-out decision is only one of many relevant criteria the banks use. No one who was interviewed indicated that interest rates were changed as a result of a firm's opt-out decision. The large suppliers follow to a large degree the same policy of the three savings banks that do not require audited accounting reports. These suppliers, however, are more willing to take risk because their revenue would decline substantially if they would sell only to those companies with high credit quality

3.5 Summary of Chapter 6, «Opting out and tax avoidance»

The goal in this chapter is to examine whether opt-out companies' economic development after opting out suggests that these companies avoid duties and taxes (henceforth referred to as tax avoidance) to a larger degree than before opting out. The possibility for greater tax avoidance by opt-out companies is present given that these companies no longer have their accounting reports and tax returns controlled by an auditor. Consequently, opt-out companies have more possibilities for reporting worse performance. As an example, opt-out companies could keep revenue outside of the income statement, or claim deductions for costs that are unrelated to the business.

Whether this increased possibility of tax avoidance does lead to more tax avoidance depends on a range of factors, such as a company's will and capacity to break the law and its assessment of the risk of being discovered and punished. One possibility is that some companies wish to understate their tax obligations but choose not to because they expect the tax authorities to inspect the tax reports of opt-out companies more often than the tax reports of firms that kept their auditor. Another possibility is that companies do not wish to avoid taxes because they think that complying with tax laws is important, because they wish to contribute to the financing of public goods, *etc*. This countervailing mechanism means that making unambiguous predictions about the impact of opting out on the frequency and scope of tax avoidance is not possible. This question can be answered only empirically.

As with analyses of almost all forms of criminality, good data on tax avoidance is not available because those who commit criminal acts often wish to conceal their behavior. Hence, researchers are required to use indirect methods, with varying degrees of costs and benefits. In this chapter, we use register data to examine whether opt-out companies' economic development is consistent with increased tax avoidance. The estimation method is inspired by tests that are used in studies of profit shifting in multinational corporations. The idea with this test is to examine whether voting down the auditor is correlated with increased tax avoidance, after controlling for factors that can explain national variation in profitability between companies. Two examples of factors that can explain such natural variation are investments in depreciable assets, which increase depreciation and amortization, and the taking out of loans, which increase interest expense.

We use several measures of performance (operating income, income before tax, and net income) as well as accounts from the accounting reports to test whether a company's economic development after opting out is consistent with increased tax avoidance. The measures we use are chosen because they can reveal changes in the share of sales that are entered into the accounting system or because claiming that certain expenses are business-related is easier with certain types of expenses than with others. As an example, many business owners travel for private matters, and such travel expenses can more easily be included as a business expense when the company is not audited. In addition, we examine the scope of changes in a company's claims on the owner (loans that shareholders take from the company). In all, we use 16 different measures that can reveal a change in tax behavior. One of these measures is taxable income as calculated by the companies (henceforth selv-reported income), but the results from the use of this measure cannot be given very much weight. This lack of confidence arises because the companies themselves must make the corrections in the tax form, and the analyses in chapters 7 and 9 show that opt-out companies make more mistakes in their tax returns, including more mistakes on page 4 of the tax form. If opt-out companies forget to a larger degree the reversal of, for example, the tax expenses on page 4 of the tax form, these companies will by definition have less self-reported income because the tax costs will not be added back in. In this case, possible differences in self-reported income would reflect mistakes in filling out the tax form, not efforts to engage in tax avoidance.

The data come from 2005 through 2012. The sample consists of opt-out candidates in 2011. We exclude opt-out candidates that opted out in either 2012 or 2013. In this way, we can be more confident that opt-out companies' accounting reports and tax papers in 2012 are not audited. To examine the impact the impact of size and the number of years a company has had an auditor (measured by the number of years the company has delivered its annual accounting report to The Brønnøysund Register Center), we divide the sample into different sub-samples. When we examine the development over time in operating income, pre-tax income, net income, gross profit, nine expense entries, and claims on the company's owner, we find no results that support the notion that companies begin to engage in tax avoidance after choosing not to be audited.

Certain industries are linked with the use of illegal labor and with tax avoidance to a greater degree than are others. The estimation method used in the analyses (regression analysis with firm-level fixed-effects) controls for a company's industry. One possibility, however, is that worse tax behavior and increased tax avoidance in a few industries was not revealed because the results are dominated by law-abiding companies. To examine this possibility, the analyses are repeated on an industry-level. We use both a company's main industry group, where the companies are divided into 17 categories, and a company's three-digit industry code, where the companies are divided into 77 industries. We require at least 50 observations in each industry in the years 2010 and 2012. Also, because we use as a dependent variable gross margin, we require that the companies have a reasonable level of inventory. With this approach,

we have in all 1,455 tests about changed tax behavior in 2012 compared with 2010. In at least 10 percent of the tests, the coefficients are significant, but the signs of the coefficients are positive almost as often as they are negative. Hence, these tests indicate that a company's economic development is consistent with tax avoidance just as often as its development is inconsistent with tax avoidance. A few industries, however, often have results that indicate increased tax avoidance: industry code 31, hunting and fishing; industry code 452, maintenance and repairs of buildings, industry code 501, navigation with passengers; industry code 591, operations in film, video, and TV; and industry code 592, production and issuance of music. Companies in those industries with a suspicious development account for 2.6 of all companies. Hence, for 97.4 percent of companies, we cannot demonstrate behavior that suggests a systemic increase in the scope of tax avoidance by companies that opted out. The effects on the tax authorities' collection of revenue indicated by inspections support the conclusion of little tax avoidance by opt-out companies.

3.6 Summary of Chapter 7, «Inspections by the Norwegian Tax Administration»

In 2011, the Norwegian Tax Administration (Skatteetaten, NTA) was asked to register any changes in accounting quality with companies that chose to opt out. The objective was to examine whether opting out affected the quality of companies' accounting information. The survey was structured so that its results would be generalizable. A little more than 2,100 companies were inspected.

The control consisted of a form with roughly 80 questions and control points that are tied to a company's accounting and bookkeeping routines. The inspections covered two years before and one year after the opt-out decision for at least 1,300 companies and two years before and two years after for at least 800. Each inspection was conducted in part by a visit with the controlled company. The inspection must be viewed as very comprehensive. The inspectors used on average 25 hours per inspection. Using average hourly rates for auditors, the average time an auditor spend on an audit of opt-out companies is 13.8 hours. The inspectors from NTA evaluated how a company set up its bookkeeping and accounting. In addition, the inspectors conducted sample tests of documentation so as to examine whether the quality of the document is consistent with the requirements imposed on companies.

Based on the control points, we have made indices that measure the quality of the bookkeeping, the accounting systems and reporting, and the documentation of the accounting information, hereafter called the quality of the company's internal accounting system. The three main findings are as follows:

(1) Companies that choose not to be audited have lower quality in their internal accounting systems than those that retain their auditor, all else equal. This difference in quality is statistically significant but is modest in size. We measure quality with an index that goes from 0 to 1, where a higher value indicates better quality. The average value for all companies is 0.868. The average for opt-out companies is 0.4 percentage points lower, all else equal. This result implies that opt-out companies had lower quality also while they had their auditor.

(2) This difference in quality between opt-out companies and companies that kept their auditor increases after opt-out companies no longer have an auditor. This reduction in quality is fairly large. For opt-out companies, the index declines by 2.0 percentage points after opting out.

(3) This decline in quality among opt-out companies does not apply for those that had external help in setting up their annual accounting reports. «External help» denotes the use of an external accountant or an auditor. In the years opt-out companies were not audited, the quality index is 2.9 percentage points

higher for opt-out companies that use external help than for those that do not. Given that the index goes down by only 2.0 percentage points when opt-out companies are not audited, this result indicates that the use of external help compensates in full for the decline in quality that results after opt-out companies vote down their auditor. Hence, this result implies that the decline in accounting-systems quality among opt-out companies is due only to those opt-out companies that do not use external help in setting up their annual accounting reports.

The control form consists of seven main themes. The results discussed above are due to theme number three, «System for bookkeeping and accounting reporting». The control points in this area are related mainly to whether a company's routines secure compliance with basic bookkeeping principles and the correct treatment of the value-added tax and to required pay statements. These areas are easy to make mistakes in for individuals who do not have specific competence within accounting, bookkeeping, and taxes and duties, as do auditors. In the other areas, the regulations are simpler and easier to understand. Hence, in these areas, companies can more easily satisfy the requirements for good quality without help from an auditor. We thus find that the reduction in quality arises in the area where the loss of the auditor's expertise that results from opting out could be expected to be largest. We find no evidence that opting out leads to a decline in quality in any of the other six main themes, regardless of whether we analyze each theme separately or combine these themes in different ways.

3.7 Summary of Chapter 8, «Opting out and accounting quality»

This chapter tests whether accounting quality for opt-out firms has declined. In this chapter, «accounting quality» denotes the ability of a company's statement of accounts to reveal the company's economic substance, or what can be describe as reflecting economic reality. In this context, accounting quality is defined in relation to the value the accounting information has in communicating to users relevant information about the company's earnings and economic position. In some contexts, such as in connection with the goal of the inspections discussed in chapter 7, accounting quality is perceived as a measure of the extent to which a company's accounting systems complies with provisions in the bookkeeping law about the registration and documentation of accounting information.

Six different measures of accounting quality are used: (i) abnormal or judgment-based accruals in total accruals. Accruals are accounting entries that cause the period's accounting-related results to differ from the period's net cash flows. Often, accruals are based in part on estimates and judgment. Examples of accruals include provisions for future warranty claims and depreciation of machines. In this measure, the scope of abnormal accruals is measured. «Abnormal accruals» denotes the use of judgment-related accruals that exceed what could normally be expected. We examine whether the magnitude of abnormal accruals has increased among opt-out companies. (ii) Short-term accruals. Much of the intuition is the same as in (i), but short-term accruals are connected to a larger extent to inventory and operating capital. The common feature of these accruals is that they can be detected by the change in working capital, or the change in working assets less the change in short-term debt. (iii) Accruals in earnings, as a measure that tries to uncover abnormal accruals tied to net income. (iv) The relation between the absolute value of short-term accruals and cash flows from operations. This point builds on the same intuition as the other measures. (v) and (vi): Measures for conservative accounting. Conservative accounting is marked by a low estimation of equity, which generally arises because the demands for recognizing income are higher than are the demands for recognizing costs. As a rule, unrealized income is not recognized, while unrealized costs and unrealized losses are recognized as soon as they are known. This difference contributes to a low estimation of equity and thus to conservative reporting of equity.

The point of departure is that we will test whether accounting quality has declined for opt-out companies. To do so, we compare opt-out companies with a) opt-out candidates that did not vote down their auditor, and b) neighbor companies. «Neighbor companies» denote companies that lie just above the threshold values which companies must be below to be eligible to opt out. The only difference between the definition of opt-out candidates and neighbor companies is that the revenue limit for neighbor companies is set at NOK 10 million. To ensure that the results are not driven by a large number of companies with very low sales or total assets, we require companies to have sales and total assets of over NOK 1 million. Most analyses are executed by comparing results for 2010, 2011, and 2012, but we conduct also tests where we use data for the years 2006-2012.

In general, the tests give no support to the notion that accounting quality declined. We do find, however, clear signs that accounting quality has declined among those companies with the largest potential for a decline in accounting quality, such as companies with large amounts of inventory or account receivables or some combination of the two. This result holds when the comparison is between opt-out companies and companies that retained their auditor and also when the comparison is between opt-out companies and neighbor companies. Companies that have high levels of inventory or accounts receivables are companies that can use discretion in accruals to a larger degree than companies with low levels of inventory or accounts receivables. In addition, we find support for the notion that companies that opt out have less conservative accounting relative to companies that could have opted out but did not do so and also relative to neighbor companies. Given that conservative accounting is perceived as a sign of quality, this result gives further support for the notion that opt-out companies have lower accounting quality than do similar companies. The results, however, must be interpreted with a certain degree of caution. We cannot, for example, estimate how the act of opting out itself affected accounting quality. Making such an estimate would require several years with observations after the opt-out decision. Furthermore, the measures of accounting quality that are used are only indirect measures of quality that can give only a certain indication of accounting quality.

3.8 Summary of Chapter 9, «Opting out and the quality of required reporting: Analyses of the tax form»

The NTA has several types of automated controls that give a signal upon finding a mistake or deficiency in the tax forms the taxpayers send in electronically. In this chapter, we use signals from three of these automated controls to examine the following questions: (1) Did the quality of the tax returns vary between opt-out companies and the other opt-out candidates before the opt-out law was introduced? (2) Did opt-out companies experience any decline in quality of the tax returns after opting out? (3) Do the use of external accountants contributes to higher quality on the tax returns? (4) Do learning take place, meaning that the quality of the tax returns increases after the opt-out year as time goes by? We call the three control areas «formal quality», «material quality» and «missing from quality». The control area «formal quality» gives a signal when, among other instances, a submitted form lacks information in a required field. The control area «material quality» gives a signal when, among other instances, the basis for the calculation of the tax assessment may be incorrect. The control area «missing form» gives a signal when the taxpayer sends in an incorrect form or some required forms are missing. Going forward, this control area is denoted by «form quality».

The sample consists of 93,311 opt-out candidates (see chapter 2). These companies are analyzed from 2006 through 2013, provided that they existed throughout the entire period. In this way, we can examine whether the opt-out companies and companies that retained their auditor had the same quality in their

tax returns before the opt-out law was introduced in 2011. In addition, we can examine whether quality declined for the opt-out companies and whether quality increased again in 2012 and 2013. For most of these companies, we have data from the tax return with appendixes and other company-specific information for the years 2006-2012. Hence, we examine whether the control signals correlate with a company's size, its debt ratio, whether the company has an accountant, whether the company has remarks in its audit opinion, *etc*.

The results show that the quality of the tax return, regardless of how quality is measure and which estimation method we use, has declined significantly for opt-out companies in 2011 and 2012 compared with 2010. This quality decline is especially strong for companies that do not use an external accountant. The use of an external accountant contributes to fewer control signals in both 2011 and 2012, and in 2012, using an accountant has a positive effect on the quality of the tax return. This positive effect is almost as large as the negative effect that comes about when a company votes down its auditor. In 2011, however, opting out has a clear negative effect on the quality of the tax return, even after taking into account the positive effect of using an accountant. Hence, the response to questions 2 and 3 is a clear «yes».

The response to question 1, whether opt-out companies and companies that kept their auditor differed in quality when all companies were required to be audited, is more ambiguous. The results indicate that compared to companies that kept their auditors, opt-out companies had more signals relating to formal quality but fewer controls relating to material quality and form quality. We have not been able to document why, prior to the passage of the opt-out law, opt-out companies should have had fewer control signals in material quality and form quality. One possible explanation is that we do not manage to control for potential differences between opt-out companies and non-opt-out companies potential for making mistakes. In this case, opt-out companies might have done better because they had fewer possibilities to make a mistake.

We examine also whether companies exhibit learning effects, so that the scope and frequency of signals declines over time (question 4). For opt-out companies, we do not see any clear signs that the number of signals was lower in 2013 than in 2011 and 2012. When we look at the effect of the opt-out companies that use an accountant (where our data stops in 2012), we find that opt-out companies that use an accountant have more mistakes than companies that retained their auditor in 2011 but not in 2012. This result is consistent with the idea that the accountants became better at filling out the tax form from 2011 to 2012, implying a learning effect.

3.9 Summary of Chapter 10, «Opting out and audit quality»

The adoption of the opt-out law has affected the market for auditors because a large share of the smallest clients of audit firm have been able to choose not to be audited, and many have done so. This outcome might have affected the behavior and business patterns of both audit clients and auditors. One possibility is that audit quality has declined. This outcome could come about if the decline in the pool of possible audit clients led to increased competition for those clients that remained, so that auditors became more likely to comply with the wishes of their clients. Alternatively, audit quality might not have changed. This outcome could come about if auditors follow auditing standards regardless of what happens with the demand for audit services, or if companies that wished not to be audited used a low-quality auditor. With respect to the price, one reasonable assumption is that prices have declined since demand declined. The objective of this chapter is to examine, with the help of register data, whether the quality and price of auditors has declined in connection with the adoption of the opt-out law.

Satisfied customers are good for the seller because satisfied customers are more likely to come back and buy more. To have satisfied clients, auditors can avoid conflicts with their clients or reduce their prices. Hence, one possible reaction to the uncertainty that resulted from the discussion of the opt-out law is the development of fewer remarks in the audit report and lower prices. As a result, we ask whether 1) the use of modifications and qualifications in audit reports and 2) real price growth in auditing declined in the years surrounding the introduction of the opt-out law (2010, 2011, and 2012) compared with the years before (2007, 2008, and 2009). In addition, we ask whether 3a) the decline in remarks in the audit report and 3b) the decline in the real price of audit services is larger for opt-out candidates than for companies that were not eligible to opt out in the years surrounding the introduction of the opt-out law than in the years before. The motivation behind questions 3a and 3b is due to the assumption that opt-out candidates could have more effectively put pressure on auditors relative to companies that were not eligible to opt out, given that opt-out candidates could have threatened both to stop buying audit services and to change auditors. Companies that were not eligible to opt out could have threatened only to change auditors.

The response to questions 1 and 2 is a clear «yes». The use of qualifications and reservations in the audit report and the real price growth in audit services has declined. We control for the change in the number of companies over time and for differences in how companies develop over time and obtain the same conclusions. For question 3a, the answer is «no». Opt-out candidates continued to get more remarks in the audit report than companies that were not eligible to opt out. This result is not a result of comparing companies of very different sizes, given that we have the same finding when we analyze companies that have roughly the same size, as measured by sales. For question 3b, whether the decline in prices in audit services around the adoption of the opt-out scheme was larger for opt-out candidates than for non-opt-out candidates, the answer is «yes». The percentage growth in audit fees over 2010-2012 is lower for opt-out candidates than for those companies that were not eligible to opt out. These results support the hypothesis that auditors give fewer remarks and charge lower prices because they are concerned about losing clients. This conclusion, however, is premature, given that we have no controls for the reasons for this observed development. Hence, we must take into consideration that this development has other causes.

Determine whether the opt-out law has affected audit quality is difficult, for two reasons. The first is the lack of reliable tests of the reason why the effects are correlated. If we find results that indicate that audit quality has changed, we cannot conclude that the reason is the introduction of the opt-out law. This uncertainty means that the results must be interpreted with caution, even though we use methods that are established in the international literature. The second reason is that audit quality is difficult to define and measure. The measures we use are deviation from a clean audit opinion and two measures of the degree of earnings management, both of which are dominant in the international literature. A deviation from a clean audit opinion comes about when the auditor takes reservations or qualifications, with the conclusion that a statement on the accounting statements cannot be given or that the accounting statements examined as part of the audit ought not to be fixed as the company's annual reports. (Hereafter, we use audit remarks as a common concept about deviations from a clean audit opinion.) The two measures of earnings management are measures that quantify abnormal accruals, but in different ways.

We use the hypotheses about audit-fee dependence to test whether the introduction of the opt-out law could have reduced audit quality. The point of departure in this hypothesis is that auditors should be independent of their clients and that independence implies, among other things, a lack of correlation

between how much customers pay for the audit or purchase in additional services and the probability that the customer gets a remark in the audit report. If we find empirical regularities that indicate that audit quality goes down for companies that pay abnormally high audit fees or purchase abnormally high quantities of additional services, we would have support for this hypothesis. We test for changes in audit-fee dependence in connection with the introduction of the opt-out law (*i.e.*, whether the covariation between abnormal audit fees and audit quality is different in the years 2010, 2011, and 2012 compared with the three previous years (2007, 2008, and 2009). We estimate abnormal audit fees as the difference between the audit fees actually paid and normal audit fees. Normal audit fees are estimated using a model with 35 explanatory variables in addition to controls for industry and region. The explanatory variables cover, among other factors, the impact of size, complexity, and risk on audit fees.

The analyses include companies that are not eligible to choose to opt out and companies that are eligible to choose to opt out. The most important group is companies that cannot opt out. The reason is that from an economic point of view, these companies are the most important. For these companies, a potential reduction in audit quality can have large negative consequences in the form of misleading accounting information and mistaken audit opinions. The chances that audit quality is negatively affected, however, are largest among companies that can opt out, as these companies can choose either not to be audited or to change auditors. Companies that are not eligible to opt out can only change auditors.

For companies defined as large (have operating income of at least NOK 5 million in the years they are included in the sample period), we find no sign of changes in the correlation between audit fees and the measures of audit quality. For companies defined as small (that have operating income of less than NOK 5 million during the sample period) and for opt-out candidates in 2011 and 2012 that choose not to opt out, we find a few result that indicate that audit quality has declined. Given that a potential decline in the audit quality of large companies can have large and serious consequences, the finding of no changes in audit quality among these companies is reassuring. For small companies, however, some of the results point to a decline in audit quality when abnormal audit fees increase, but these results are not clear and unambiguous.

3.10 Summary of Chapter 11, «Cost-savings for opt-out companies and other companies»

The theme in this chapter is the impact of the opt-out law on the cost savings for companies, both those that have chosen to opt out and those that have chosen to retain their auditor. We estimate savings on both a net and a gross basis. Gross savings is the money saved from not paying audit fees. Net savings is gross savings adjusted for the other effects of opting out. Such effects could include increased fees to the accountant, higher interest rates on loans, and a decline in wage expenses that result when employees use less time on meetings and discussions with the auditor, with counting inventory, with issues that relate to documentation, *etc*. Hence, for opt-out companies, net savings could be either higher or lower than gross savings.

We estimate cost savings for opt-out companies in three different ways. In the first, we use regression analyses. We compare opt-out companies' earnings before and after opting out with the development of similar companies that kept their auditor. This method allows us to capture many of the indirect effects of opting out, such as losses that can arise because of less control of the employees, higher fees to the accountant, reduced wage expenses, *etc*. We use as dependent variables different measures of earnings (scaled by operating revenue or total assets), but we argue that the largest weight should be laid on the results that arise with operating income scaled by operating revenue. This measure is most reliable

because the other measures are affected to a larger extent by effects that do not have a clear connection with a company's opt-out decision. (Based on the analyses in chapter 5, we can look away from negative financing effects.)

In the second method, we estimates what opt-out companies would have paid in audit fees if the opt-out law had not been introduced. We either add or subtract a premium that is based on what representatives from the opt-out companies gained or lost in time as a result of opting out. These estimates are collected from a questionnaire given to representatives from companies that opted out. When we estimate what opt-out companies would have paid in audit fees, we take into account the findings from chapter 10 that indicate that audit fees have changed over time, with real price growth in the years 2010, 2011, and 2012 being far lower than in the period 2007, 2008, and 2009. This change in growth rate applies to both opt-out candidates and companies that were not eligible to opt out. Hence, companies that were not covered by the opt-out law have achieved benefits with the introduction of the opt-out law because the price they must pay in audit fees has declined. When we estimate the total gross savings that results from the opt-out law, we estimate the benefits of the decline in audit fees for such companies as well as for companies that chose to keep their auditor. To go from gross savings to net savings, for opt-out companies, we take into account changes in the time use that results from opting out. These estimates or more or less use of time are collected through a questionnaire where the respondents are asked to estimate the time effects of opting out. The third method involves asking representatives of opt-out companies directly what they believe the company has lost or gained, measured in NOK, from opting out, all effects included.

With respect to gross savings, the results are as follows:

- The estimate of average gross savings in 2012 for opt-out companies is NOK 14,000. For newly established companies without an auditor, average gross savings is NOK 7,000.

- For all AS, gross savings in 2012 amounted to NOK 1,218 million. Of this total, gross savings of newly established companies without and auditor and opt-out companies accounted for NOK 896 million, or 73.6 percent. AS that chose not to opt out or that did were not eligible to opt out achieved gross savings of NOK 321 million.

With respect to net savings, the results are as follows:

- Among opt-out companies, net savings calculated as gross savings corrected for lost time or gained time gives an average net savings of NOK 19,250. Gross savings is NOK 14,000, while the value in NOK of saved time amounts to NOK 5,250, on average. We come to this estimate of saved time by multiplying the respondents' estimate of saved time with the hourly wage in 2012 for the group of workers used for calculating administrative savings in the report «Utviklingen i administrative byrder for næringslivet. Oppdatering for perioden 2006-2009». Also, we account for the effects of not having to pay the payroll tax for these hours saved.

- When the respondents are asked to estimate net savings with all effects included, they indicate net savings of NOK 19,950, on average.

- When net savings for opt-out companies is estimated with regression analysis, measured as the effect of opting out on operating income, the point estimate for net savings per company is NOK 23,600. When we examine the magnitude of the uncertainty around this point estimate, we find a 95 percent probability that the true cost savings lies between NOK 15,000 and NOK 31,600 per

company, on average, for opt-out companies in 2012. This estimate takes into account that many opt-out companies use external accountants.

– In 2012, net savings for all AS taken together is NOK 1,598 million. This figure is the sum of saved audit fees (NOK 1,218 million), saved time use for established companies (NOK 291 million), and saved time use for newly established companies (NOK 89 million). When we take into account that companies that are required to be audited have benefited from the general decline in audit fees, the estimate for net savings for all companies is NOK 1.6 billion.

The different methods (trend projections, questionnaire, and regression analyses based on register data) give very similar estimates on net savings. This result, where different methods give roughly the same results, indicates that the responses are reliable.

Net savings is higher than is gross savings, and increased fees to accountants did not have a strong effect, both of which could be somewhat surprising. One possible explanation, not examined, is that companies might have been more reluctant to include in the company's books personal expenses. When companies were audited, if the tax authorities discovered in a company's accounts expenses that should not have been laid on the company, a company could defend itself by arguing that its accounting statements had been approved by its auditor. After opting out, however, companies can no longer do so and could be more careful as a result. In this case, a company's expenses could decline, increasing its income.

3.11 Summary of Chapter 12, «Costs and benefits for opt-out companies, as illustrated with a questionnaire»

This chapter covers the results of a questionnaire executed among representatives of opt-out companies. The goal with this questionnaire is to collect the respondents' perception about the costs and benefits of choosing not to be audited. In all, 396 representatives responded to the questionnaire. The responded are better-educated in relation to the key decision-makers in opt-out companies. («Key decision-makers» denotes management, the chairperson, and up to the two largest shareholders as measured by their share of ownership.) For the key decision-makers in the typical opt-out company, 16 percent have a master's degree, and 27 percent have a bachelor's degree. The corresponding figures for the respondents are 34 percent and 33 percent, respectively. In addition, the respondents are better-educated within accounting, which is not surprising, as those who are more interested in accounting likely would be more likely to participate in the questionnaire than would those with little interest.

Using professional help to fill out the tax returns and accounting reports is very common. 91 percent of companies use an auditor, an external accountant (an authorized accountant not employed by the company), or an authorized accountant employed by the company. Using help as part of bookkeeping is somewhat less common. Only 79 percent of companies use either an auditor, an external accountant, or an accountant employed by the company. When we exclude internally employed accountants, the share that receives help from an accountant on the accounting statements and the tax form is 76 percent and 87 percent, respectively. These percentages are on the same level as the numbers that resulted in the register-based analyses in chapter 4.

Respondents from companies that neither use external accountants or an auditor to fill out the tax form were asked to express their degree of agreement with the claim, «Mistakes can happen when setting up the annual accounting statements or the tax papers, but these mistakes are not substantial or important». 38 percent of respondents agreed with this claim, 54 percent disagreed, and eight percent neither agreed

nor disagreed. Hence, more than one-third of the respondents are aware of the possibility of mistakes but think that the mistakes are not important. This attitude could help explain findings from other chapters. In chapter 7, we find that opt-out companies have lower-quality accounting systems than do companies that kept their auditor. In addition, in chapter 9, we find that opt-out companies have lower quality on the tax returns than do companies that kept their auditor. These results are consistent with the finding that one-third of the respondents believe they can make mistakes in setting up the accounting or the tax returns. The finding that these mistakes are not seen as economically important is in line with the findings that opting out is not correlated with more tax avoidance (chapter 6) and that the largest tax avoidance was discovered among companies that retained their auditor (chapters 3 and 16).

The respondents were asked to indicate which work assignments they use more or less time on after opting out. On all assignments, the respondents reported significant time savings. In order of decreasing importance: end-of-year statement reconciliation, meetings with the board and shareholders, making accounting entries, the board's annual report, meetings and dialog with accountants, ensuring that assets and liabilities are accounted for at the correct value, and professional questions connected to accounting and tax. In addition, time on communication with the accountant who does the accounting entries has declined. This result could arise because almost one in five respondents never had contact with their auditor, which is possible because communication with the auditor can go through the accountant.

When a company votes down its auditor, one possible outcome is that fees paid to the accountant increase because the accountant might have to do more work with the tax returns and accounting reports. In addition, the accountant might have to do extra work to make sure that the accounting is correct. Only 21 percent of the respondents, however, agree that fees to external accountants or time use of the internal accountant has increased after opting out. The perception is that neither fees to the accountant nor the time use of the internal auditor tied to the tax returns or annual accounting reports has increased after opting out. These responses are consistent with the analyses in chapter 11 of cost savings, where we find little economic effect of the use of an accountant by opt-out companies in the regression analyses.

With respect to the reactions of interested parties after a company opts out, the perception is that banks and suppliers have not reacted, while customers, owners, employees, and the accountant have reacted in a very positive way. The claim about no negative financing effects is in line with the results in chapter 5.

The majority of the respondents, 51 percent, do not agree that accounting quality declined after opting out. 11 percent partially disagree, and 38 percent neither agree nor disagree. With respect to the claim that engaging in tax avoidance is easier without an auditor, the responses are similar: 52 percent disagree, 36 percent neither agree nor disagree, and 13 percent agree. Only four percent are fully or partially in agreement that tax avoidance in general has increased in companies without auditors. 44 percent neither agree nor disagree, while 52 percent disagree. For all three claims, the perception of the respondents, on average is different from the neutral either-or option.

3.12 Summary of Chapter 13, «Mergers and spin-offs»

If owners of AS companies perceive that operating without an auditor is beneficial, one result could be fewer mergers among small AS companies. Another could be more spin-offs. Mergers could lead these companies to exceed the size thresholds a company must be below to be eligible to opt out, while spin-offs could help companies get below these thresholds. This chapter examines whether the development in the number of mergers and spin-offs over time has a pattern consistent with the idea that companies

break up or avoid merging as a way to avoid exceeding the threshold values for opting out (annual sales of NOK 5 million).

The results are clear: We see neither a sign of fewer mergers nor a sign of more spin-offs following the introduction of the opt-out law. We see also that among the companies that emerge from a spin-off, the probability of opting out is lower in 2011, 2012 and 2013 than in 2009 and 2010. Over 2011-2013, 8.5 percent of the companies that emerged from a spin-off opted out, compared to 19.5 of such companies in 2009 and 2010. If companies use spin-offs to come under the size thresholds for being eligible to opt-out, the probability of opting out should be higher, not lower, among the companies that emerge from a spin-off in 2011, 2012, and 2013 compared to earlier years. We find the opposite.

3.13 Summary of Chapter 14, «Newly established AS companies»

The previous chapters analyze mainly companies that have had an auditor but have had the possibility to choose to vote down their auditor. This change in the audit law has affected also newly established companies because such companies now can be established without an auditor. For a newly established company, however, we cannot compare the situation before and after opting out, as we do for opt-out companies. Hence, from a methodological point of view, analyzing the impact of the opt-out law on these newly established companies is more difficult. Analyzing the impact of the opt-out law on newly established companies is complicated further by changes in the company law that entered into force at the start of 2012, changes which, among other effects, reduced the cost of establishing an AS company.

When important changes in laws come into force at roughly the same time, identifying the effect of each law can be difficult. In the case of the opt-out law, separating effects that are due to the opt-out law from effects that are due to the lower requirements for share capital is difficult. One reason for this difficulty is that the strong increase in the number of newly established AS companies cannot be explained by a change in preferences of organizational form, where companies started to prefer the AS form to the ENK or NUF form (chapter 2). Hence, the law changes could have led to a number of new companies that we have not had before. For these companies, we do not have a relevant basis for comparison. Another reason is that information about newly established companies is lacking, and the information that does exist is only for the first year. As a result, drawing conclusions about what could cause differences in newly established companies is difficult.

Though evaluating the effect of the opt-out law on newly established companies is not possible, looking closer at these companies is interesting. This chapter presents first the results from a questionnaire for representatives of newly established companies. One key objective with the questionnaire is to get an explanation about the importance of the change in the audit law relative to the changes in company law that lowered capital requirements. We next show results from register-based analyses of the tax returns for newly established AS companies. The purpose of these analyses is, among other things, to examine whether the opt-out law has resulted in lower-quality tax returns among newly established companies and whether a correlation exists between the quality of the tax returns and the level of share capital. We use the same measures of tax-return quality as in chapter 9 – the signals from the tax department's automated controls. The time period in these analyses is 2009-2013.

Based on the responses, new activity takes place in 63 percent of the newly established companies. In three percent of the establishments, the activity took place earlier in an NUF company, and in 20 percent of the establishments, the activity took place in an ENK company. If we use as a starting point the 26,000 newly established AS companies per year in 2012 and 2013, we get an estimate of 16,380 AS companies

with new activity. In addition, almost 800 AS companies are established each year to take over business previously operated in an NUF company.

With respect to the importance of the opt-out law to the company's establishment, 25 percent responded that they would have chosen another company form, and 23 percent responded that the company would not have been established, if the opt-out law was not passed. On the question about the importance of the change in company law that allows companies to be established with less than NOK 100,000 in share capital, 31 percent of the respondents said that they would have chosen another company form, and 38 percent said the company would not have been established, if this change was not put in place. Hence, the increase in newly established companies was due to a larger degree to the lower capital requirements than to the possibility to vote down the auditor. For some the respondents, the company's establishment depended on both the opt-out law and the change of the company law. After taking into account this joint dependence, the number of AS companies that were established because of the opt-out law and the change in the company law is estimated to be 12,800 in each year in 2012 and 2013. Of these companies, 5,920 would have been established in another form if the law changes were not put in place. In chapter 2, the law changes were estimated to have led to around 13,300 new companies per year. The responses give an estimate of 12,800 new companies due to the law changes. When accounting for the uncertainty tied to these estimates, the conclusion is that these two methods give roughly the same response.

In most cases, the representatives for the newly established companies have the same opinions as do the representatives for the opt-out companies in chapter 11. Newly established companies get professional help more often in connection with the tax form than with bookkeeping; slightly more than one-third of the respondents agree with the statement, «Mistakes can happen when the company prepares its annual accounting reports and tax papers, but these mistakes are not substantial or important»; banks and suppliers have reacted neither positively or negatively; and the companies believe they save time by not having an auditor. In addition, for questions about the effect on accounting quality, the possibility to engage in tax avoidance, and the notion that opt-out companies use tax avoidance to a greater degree, the responses are largely the same as for opt-out companies.

The register-based analyses show, among other findings, the following: Around 70 percent of companies established in 2012 and 2013 are established without an auditor, and around 20 percent have neither an external accountant nor an auditor. For newly established companies, the share that get signals in the tax authorities' automated controls are 5.3 percent in both 2012 and 2013. For opt-out companies, these figures are 6.8 percent in 2012 and 6.3 percent in 2013. For companies that are too large to be eligible to opt out, these figures are 11.1 percent in 2012 and 9.7 percent in 2013. Hence, for companies that are not newly established, these numbers show that the number of control signals increases in the size of the company. This result is reasonable: On average, larger companies have more forms that must be sent in than do smaller companies, so that such companies have more opportunities to make a mistake.

The share of newly established AS that received a control signal has declined somewhat from 2009 to 2013. This decline could be due to the size effect noted in the previous paragraph: The share of small companies in 2012 and 2013 could be larger than in prior years, reducing the potential for control signals. With the qualification that we do not control for the potential number of mistakes, these analyses do not indicate that the changes in the company law reduce the quality of the statements submitted to the tax authorities. Conversely, analyses of companies established from May 1, 2011 through the end of 2011, eight months during which companies could be established without an auditor but were subject to the same capital requirements as in the years before, indicates that the quality of the statements of companies established without an auditor goes down significantly. In addition, these analyses show that the number

of control signals is lower with companies that use an accountant or auditor, but we cannot say whether the accountant is more important for quality than is the auditor, or *vice versa*. One reason is that we lack a way to measure differences across companies in the potential number of control points in the statements.

3.14 Summary of Chapter 15, «The development in the auditing and accounting industries»

This chapter describes the economic development in the auditing and accounting industries in the years 2000-2012. The goal is to illustrate how the two industries' profitability and growth has developed and how the growth in profitability has changed in the years surrounding the opt-out law. We examine also the development in the number of those who have received approval as an auditor or authorization as an accountant. All amounts given in NOK are converted into the value of NOK in 2012 using the consumer price index, so that the sums are comparable over time.

The number of auditors and audit firms that have applied for and received approval as an accountant or an accounting firm has increased strongly. In 2000, 12.3 percent of the 4,167 approved auditors were authorized as an accountant. In 2013, 34.8 percent of the 6,957 approved auditors were authorized as an accountant. This increase in the number of auditors and audit companies that have applied for and been granted authorization as, respectively, an accountant and an accounting firm was particularly strong in 2011 and 2012. One reasonable explanation for this strong increase is the introduction of the opt-out law and the desire of auditors to take on accounting-related assignments.

The number of approved audit companies has declined since 2009, from 817 approved audit companies in 2008 to 538 approved audit companies in 2012. While this restructuring in the audit industry, marked by purchases and mergers, started before the opt-out law, the decline in the number of approved audit companies was especially strong in 2011 and 2012.

Revenue in the accounting industry increased strongly from 2010 to 2012, but this increase in revenue is not especially high compared with the growth in revenue in, for example, the period 2003 to 2006 (and growth was far higher in 2007 and 2008). Hence, the opt-out law has not led to substantial growth in revenue compared with the growth the industry had experienced in earlier periods. This observation is consistent with the responses gathered through the questionnaires, discussed in chapter 12, and with the register-based analyses in chapter 11.

From 2003 through 2009, annual revenue growth in the audit industry varied between three and 38 percent. In 2010, 2011, and 2012, revenue in the audit industry has remained roughly constant, with almost no growth at all.

Ordinary income in the audit industry has declined from NOK 1,098 million in 2009 to NOK 789 million in 2012. In the same period, ordinary income in the accounting industry has increased from NOK 804 to NOK 1,071 million in 2012. For both industries taken together, ordinary income declined from NOK 1,902 million in 2009 to NOK 1,860 million in 2012. Given that services are sold at a profit, these results indicate that the level of activity in the two industries has declined. This outcome is expected, as parts of the work assignments that auditors executed for opt-out companies have fallen away.

The audit industry has higher operating margins than does the accounting industry. In 2012, operating margins were over four percentage points higher in the audit industry. Return on capital as of the end of

the period of analysis was roughly the same for both industries. The share of equity in the audit industry, however, is lower than in the accounting industry. As a result, returns on the owner's invested capital is higher in the audit industry than in the accounting industry.

The number of audit companies that have applied for and received approval as accounting companies has increased over time. To assess whether these transformations have been successful economically, we divide the company into three groups of companies: companies that have authorization only as an accounting company, companies that have authorization only as an audit company, and companies that have authorization as both an accounting company and an audit company. The pure audit companies are the companies that have had an especially large decline in revenue due to the opt-out law. These companies, however, have been able to adjust their costs to compensate for this decline in revenue, so that they still have the highest operating margins. Using returns on capital, pure audit companies have the lowest profitability in 2011 and 2012, though returns on capital still is over 12 percent. Companies that are authorized as both an auditing company and an accounting company have had the highest return on equity since 2007, although this result is due in part to these firms' relatively low share of equity. In 2012, the share of equity was under 20 percent for this group of companies, close to 30 percent for pure audit companies, and over 35 percent for pure accounting companies. The other companies in Norway that are required to file accounting reports have a share of equity of around 33 percent. The share of companies that have a loss in these two industries is highest for pure accounting companies and lowest for companies that are authorized as an auditing company and as an accounting company.

To summarize, the conclusion is that the audit industry has adjusted to the opt-out law very well. While growth in revenue has been around zero since 2010, profitability still is high, and the share of companies that have a loss is low. Among audit companies, those companies that have authorization also as an accountant have the highest revenue as well as the lowest share of equity. The accounting industry has had growth in revenue and profits, but revenue growth and profitability have not been especially high in comparison to revenue growth and profitability in 2010. Hence, the introduction of the opt-out law has not had a strong positive impact on the economic performance of accounting companies.

3.15 Summary of Chapter 16, «Consequences for the tax authorities and the revenue effects of controls of opt-out companies»

The adoption of the opt-out law and the possibility to establish AS companies with lower requirements for share capital than before (with or without an auditor) likely has had affected the tax authorities' (Norwegian Tax Administration) control and guidance operations. As an example, the demand for guidance could be higher because more companies than before no longer have access to the auditor's competence. Hence, such companies might have to ask for help more often from the tax authorities. Another possibility is that the controls of the tax returns could require more time because of a decline in the quality of the required reporting. In addition, the tax authorities might have inspected more often those companies that chose to vote down their auditor because these companies could have more opportunities to evade taxes. In this chapter, the objective is to shed light on how the two rule changes (the opt-out law and the easing of the requirements for share capital to start an AS company) have affected the tax authorities. First, we focus on the use of resources tied to the tax returns. We next examine what effect on the revenue collection of the tax authorities could be expected if the tax authorities come to inspect opt-out companies more often.

We shed light on the use of resources by using a questionnaire conducted among employees of the tax authorities whose work relates to the tax assessments of AS companies. Roughly 62 percent of those

who work in this capacity responded to the questionnaire. The respondents are very experienced, with an average of 22 years of experience. The respondents' main impressions are that the quality of opt-put companies' tax returns is reduced, the preparation of the statements is less timely, and more use of time is required to handle each case. The perception about reduced quality is consistent with the results from chapter 7 about the controls, the results from chapter 9 about the quality of the required reporting, and the respondents' answers on the questionnaires in chapters 12 and 14 (where one in three agree that mistakes can occur).

The respondents think the frequency of mistakes is lowest with companies that have both an auditor and an accountant and that the frequency of mistakes is lower with companies that have an auditor than with companies that have an accountant. The use of an accountant, however, does contribute to better quality.

Most of the respondents believe the tax morals are lower among opt-out companies than among those companies that kept their auditor. 86 percent of the respondents believe that companies that engaged in tax avoidance before the opt-out law was passed vote down their auditor more often. 68 percent believe that opt-out companies more often try to engage in tax avoidance than do companies that have kept their auditor. Finally, 72 percent believe opt-out companies more often try to engage in tax avoidance after voting down their auditor than before.

Concerning the use of time on the tax returns, 54 percent believe that the use of time has increased, while 37 percent believe that the length of time used in inspecting the tax returns is not correlated with whether the company chose to opt out. Those who do perceive an increase in time use estimate an increase in time of 25 minutes, on average. This estimate is based on opt-out companies that have neither an accountant nor an auditor. The responses show no differences in time use between companies that have an auditor and opt-out companies that have an external accountant.

The questionnaire form contains eight possible reasons that time use could have increased. Among the respondents that report an increased use of time, the two most important reasons are that the sum in the tax returns was incorrect or missing information and that the taxpayers' responses to inquiries from the tax authorities indicate that the taxpayers did not understand what the inquiry was about. The third was that the respondents were required to send inquiries more often to the taxpayers. Four reasons are deemed roughly equal in importance: more time is used on guidance, the tax papers are viewed in greater detail because taxpayers might try more often to avoid taxes, the taxpayer fails more often to respond to inquiries, and the tax papers must be inspected in greater detail because taxpayers more often make a mistake. The reason that receive least support is missing attachment, but also missing attachment contribute to increased time use.

With respect to newly established companies, 87 percent of the respondents believe that the quality of the tax papers of newly established AS companies following the introduction of the opt-out law has gone down compared to before. Furthermore, 59 percent believe that the quality of the tax papers with newly established AS companies with share capital of NOK 30,000 or less is worse than similar companies with share capital of NOK 100,000. When the quality of the tax returns of the newly established AS companies is compared with newly established ENK or NUF companies, the respondents indicate that the quality is better with newly established AS companies. Concerning the quality of the tax returns of newly established AS companies with and without an auditor or accountant and the time use on these statements, the same responses as those given for opt-out companies apply.

In the evaluation of whether companies should have an auditor or accounting, the owners can evaluate whether the probability for being chosen for an inspection increases if the company does not have an auditor or accountant. We do not have any concrete numbers on the probability for being chosen for an inspection, but we have asked the respondents whether the probability of being contacted by the tax authorities depends on the use of an auditor and accountant. The responses indicate that using an auditor and accountant can reduce the probability of being inspected.

With respect to what is most important for the correct determination of the taxable income, the auditing of the annual accounting reports is most important, while the use of an accountant instead of an auditor in filling out the tax returns is ranked as least important (but does have a positive effect on the determination). Using an external accountant in the bookkeeping, the use of an external accountant in preparing the tax form, and using an auditor instead of the company itself to fill out the tax form rank in between these two factors.

The last part of the chapter examines the expected impact on revenue (collected by the tax authorities) of inspecting opt-out companies, where the criteria for inspection is whether a company has voted down its auditor. The revenue effect can be estimated by comparing what happened in the tax returns after the company was inspected by the tax authorities. In sum, the revenue effects are on the same level as the costs incurred in carrying out the controls (roughly NOK 20 million). 84 percent of the increase in revenue, however, came from companies that have chosen to retain their auditor. The relationship between the increase in revenue per NOK used on the controls is 1.6 for companies with an auditor and 0.3 for opt-out companies. Hence, the expected increase in additional tax revenue that results from the inspection of an opt-out company is only NOK 0.30 per each NOK 1 used in the inspection. Inspections of companies that retained their auditor, however, gives an average of NOK 1.60 per each NOK 1 used in the inspection, on average. The selection procedure used to decide which companies to inspect gives no reason to believe that these results are not representative. One caveat, however, is that the sample consists of over 2,100 companies but is fairly limited, covering under one percent of all AS companies. Hence, the revenue effects could be different if new analysis were carried out, using a different sample of firms. Estimating what the results would have been or the chances of obtaining a different conclusion with a different sample is not possible.

In evaluating whether the revenue effects of the inspections are reasonable, the results from chapter 6 are relevant. When we compare the economic development of companies that kept their auditor with the development of companies that voted down their auditor, we find no indications of increased tax avoidance among opt-out companies, with the exception of a few small industries. This result indicates that the scope of possible increases in tax avoidance with opt-out companies is so small that none is revealed by the register-based tests. Some of the explanation for this outcome could be that opt-out companies might expect to be inspected more often, or that owners do not wish to operate in a dishonest way and thus do not think about the consequences of opting out on the likelihood of being inspected. Hence, companies that opt out could be companies where the owner believes no serious problems exist with the company, so that the tax authorities would not find any problems in an inspection. Conversely, companies that engage in illegal activities and that have an auditor could be reluctant to vote down their auditor. Such companies might think that opting out could increase the probability of bankruptcy, so that continuing with the auditor they have is a better solution. In such a scenario, the distribution of the revenue effects from the inspections would be the same as those noted above.

One final relevant factor is the results for the survey in chapter 12, which shows that 38 percent of the respondents in companies that use neither an authorized accountant nor an auditor agree that mistakes

can happen but that these mistakes are not substantial or important. Hence, the following findings are consistent: the respondents working with income determination in AS companies (this chapter), the controls by the tax authorities (chapter 7) and the register-based surveys of the quality of tax returns (chapter 9) show that opt-out companies deliver the tax returns with more mistakes than do companies that kept their auditor. Over one-third of the opt-out companies themselves agree with this finding. The register-based analyses of the economic development of the opt-out companies (chapter 6), however, show that the revenue effects cannot be large, as we cannot demonstrate any changes in the direction of increased tax avoidance. This result is confirmed by the small revenue effects of the controls of opt-out companies.