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Patrolling the corporation – the auditors' duty to report crime in Sweden

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Abstract

This paper analyzes the duty of external auditors in Swedish joint stock corporations to report suspicions of crime to the public prosecutor. The focus is on the auditors' experiences since the enactment in 1999. First the background, purpose and critique of the legislation are described, and analyzed with regulation theory. Thereafter follows an investigation of the effects of the legislation. Empirically the analyses are based on official documents as well as primary data from a postal inquiry survey and secondary data from previous interview studies. The analyses show that the consequences of the legislation concern the auditors' professional self-identity rather than their client relations. The decrease in client trust feared by the profession did not come about. The legal effect of the reform is ambiguous. On the one hand there are indications that the legislation is disarmed by some auditors through a "creative compliance". On the other hand the survey demonstrates a widespread "responsive" utilization of the duty, making it a useful complement to other crime control.

Keywords: Auditing, economic crime, trust, regulation theory, professions

Introduction

In Sweden, as internationally, there has been much debate over the years concerning the external auditors' role in detecting and controlling corporate irregularities, fraud and misconduct. In 1999 Swedish auditors were given a legal obligation to report crimes conducted by the managing directors or company board members to the public prosecutor. This paper analyses the legislation in terms of its consequences for the profession and its client relations, and of legal effects.

The focus is primarily on the auditors' experiences of the legislation during the first four years since its enactment in 1999. Two questions are central. One concerns whether the duty to report on crime has changed or harmed the auditors' client relations, as the profession feared it would. The other question is whether the regulation has any crime-preventive or crime-combating effects and, if so, what they are.

The paper has the following disposition. The first section presents the background and purpose of the legislation – how it was fashioned and on what grounds it was criticized by the auditors. This description is based on an analysis of the Government Inquiry Commission reports and subsequent statement of opinions, in addition to documents from the professional organization and Government agencies concerned.

The second section is an attempt to formulate a theoretical interpretation of the form and functioning of the legislation. The analysis builds on theoretical conceptualizations of auditing, as well as on the perspectives of "responsive regulation" and a "republican

separation of powers" of the corporation (Ayres and Braithwaite 1992; Fisse and Braithwaite 1993; Braithwaite 1997; 1998).

The third section is an empirical analysis of the professional consequences and legal effects of the legislation. It is based on primary as well as secondary data. The primary data material is from a postal inquiry survey of attitudes toward, and experiences of, the duty to report on crime. The inquiry was sent out during September 2003 and answered by 694 authorized and approved Swedish auditors [1]. The secondary data material consists of 30 interview studies encompassing 160 interviews with auditors practicing in different parts of Sweden. The interviews were made during the period 1999-2003 [2]. In addition to these large data materials, the analyses contain some information from interviews with representatives of the professional auditor organizations, and from documents of the Swedish National Economic Crimes Bureau (EBM).

The background and purpose of the legislation

The expectation on auditors to control crime is as old as the profession. Detection of fraud was considered an important task for the corporate auditors early on, in Sweden as in other countries. During the twentieth century, however, such crime-controlling tasks were rejected by the profession as part of an "expectation gap"; between what tasks the auditors can and should perform, and what tasks the general public, the state or the interested parties expect them to perform (Chandler et al.1993; Sjöström 1994: 29ff.; Sikka et al. 1998). Still, the issue is recurrently subjected to political discussion and ambitions in the wake of major frauds and

accounting scandals (e.g. Bougen 2000; Bougen and Young 2000; Humphrey et al.1993; Sikka and Willmott 1995; Power 1993; Tweedie 1991).

In Sweden, the external auditor's role in preventing crime has been a persistent theme since "economic crime" was established as a contested issue on the political agenda in the mid-1970s (Larsson 2001; Lindgren 2002). The repeated proposals in inquiries and political debate to employ the auditing profession in economic crime control were criticized by the profession (Larsson 2005). All attempts to change the auditors' role in such a direction would, it was held, inescapably undermine the trustful client relations necessary to conduct the audit. This line of argument was elaborated in two research reports questioning the prospect extending the auditor's duties to control and report crime. The main point was that the auditors' independence from the state was as important as the independence from their clients if their trustful and influential relations with their clients were to be maintained. To enlist external auditors in a battle against "cynical managers" would require an impossible "police role", transforming them into informers or state representatives. That would seriously damage their normal function as "promoters of legal culture" spreading law into society (Axberger 1988: 69f.), and subvert their traditional role as "controlling advisors" protecting "otherwise honest" managers from temptation in situations of crisis (Moberg 1992: 44-46).

As in the economic crime issue at large, the antagonism over the auditors' role and function decreased somewhat when the idea of using the auditors for crime control was re-framed. From a focus on the protection of state and public interests in the previous proposals, the emphasis was instead put on protecting corporations and owners from irregular competition and fraud (Larsson 2005). Consequently greater efforts were made to shape the legislation to fit the auditor's role and task within the corporation.

The duty to report on crime was created as a component in the fight against economic crime. However, its primary purpose was framed in terms of preventing illegal competition, and securing the interests of the stockholders and of other parties with interests in the corporation (creditors, employees, other contracting parties). The motivation was that the auditor's option to give remarks and formal criticism to the board or the management, and qualification of the audit report, were insufficient for protecting the corporation and interested parties. A secondary purpose, more closely articulated with the state interests, was that crimes would be detected and reported at an earlier stage than if reported by receivers in bankruptcy and crime-controlling agencies. Until now, the auditors' professional confidentiality had prohibited them from reporting crime, unless such information was specifically requested by a prosecutor conducting a preliminary investigation (Aktiebolagskommittén 1995: 228f.; Justitiedepartementet 1995b; Prop. 1997/98:99; Prop. 1998/99:19).

The shape of the legislation

In 1999, legislation was introduced requiring external auditors in Swedish joint-stock companies to report suspicions of economic offenses committed by the managing directors or company board members to the public prosecutor (Skog and FAR 2000). The duty was shaped through a civil law approach, so as to push the focus on state interests into the background and thereby disqualify the argument that client trust in auditors was at risk. The regulation obliges auditors to report serious crimes harming the company or its interested parties. Crimes committed by employees were specifically excluded from the legislation, since they were of less importance to disclose to the owners.

> To impose on the auditor duties of a criminal law nature towards the company – for instance a more extended obligation to report crime committed inside the company – would […] go less well with the auditor's role as a company trustee. There is reason to assert that measures to proceed against crime are external to the natural jurisdiction of the auditor. Regulations concerning the auditors' rights or duties to report to the police or prosecutors should therefore not be shaped so that they become a part of the criminal law sanctioning system. (Prop. 1997/98:99: 155 [translation])

The duty concerns a specific list of serious crimes, when committed by managing directors or board members: fraud, swindling, money laundering, embezzlement, breach of trust, crimes against creditors, bribery/corruption, and tax crimes. If suspecting any of these offenses, the auditor shall inform the board, and within two weeks resign and report to the public prosecutor. The obligation comes into force at a relatively low level of suspicion. The legislation prescribes that an auditor shall report any cases in which it "may be suspected" that such a crime has been committed (Ekobrottsmyndigheten 2003a).

The duty prescribes only a "passive" obligation to report crimes that the auditor becomes aware of during the regular audit. It is not an extension of the audit in order to "actively" detect crimes (cf. Power 1993). In addition, the auditor is released from his/her duty if the crime is insignificant, or is reported by another party. The auditor is also released from this duty if the company board reports the crime or rectifies it within two weeks after the auditor's admonition – that is, if conditions are restored to what they were before the crime was committed (Skog and FAR 2000). An extension of this respite to four weeks is currently in the making (Ekobrottsmyndigheten 2003b).

As pointed out by the Swedish National Economic Crimes Bureau, the submission of a report is a last step to be taken in cases of non-compliance:

> A report shall be made only when all other measures required by the duty to report have been taken without the results desired. A submission should therefore be seen as the last alternative that the auditor has at hand when all other alternatives have been exhausted. This approach is probably the one most consistent with the purpose of the legislation, that is, to prevent criminality in joint stock corporations. (Ekobrottsmyndigheten 2003a:6 [translation])

The legal sanctions linked to the reporting requirement are primarily of civil law and administrative kinds. First, the auditor may be held responsible for damages by the corporation if there is reasonable cause to assume that the information on which the report built is erroneous. This liability does not, however, cover errors in the auditor's judgment of criminal law matters. Secondly, the auditor may be held responsible for damages if neglecting to inform the board of a suspicion, but not if neglecting to report to the prosecutor after informing the board. Negligence in reporting to the public prosecutor may, though, lead to administrative sanctions from the Swedish Supervisory Board of Public Accountants (Revisorsnämnden, RN). Their disciplinary sanctions range from reminders and warnings to withdrawal of the auditor's qualification (approval/authorization) (Skog and FAR 2000).

Since the reporting requirement infringes on client confidentiality, weight has been given to the secrecy surrounding submissions. The report is classified during the entire preliminary investigation, and becomes public only if the case is delivered to the court. Thereafter, information concerning the corporation may still be classified (Skog and FAR 2000). A representative of the public prosecutor particularly emphasized, at a presentation of the legislation for the professional accountancy organizations, that the content of reports

submitted will not be public or reach the media (Balans 1995: 273). Today, reports from auditors are not even technically traceable in the prosecutors' case diary system BRÅDIS.

The critique of the legislation

Although framed and shaped to fit the auditor's role, the duty to report was questioned. The critique came from political representatives and experts within the Government Inquiry Commission, and from the professional accountancy/auditor organizations in the statements of opinion on the commission report. According to them the consequences of the regulation were not adequately analyzed, in terms of its significance for small or medium-sized companies and its consequences for the auditors' client relations. The committee was said to neglect alternative opportunities, such as giving the auditors not a duty but a right to report, or making them report to an intermediary body in which the decision to submit the report could be made subsequent to adequate criminal law considerations (Aktiebolagskommittén 1995: 293-315; Justitiedepartementet 1995a; Justitiedepartementet 1997).

The critique in the statements of opinion concerned four principal arguments. First of all, the duty was an infringement on client confidentiality, and thereby on the auditor's role as independent party. There was a risk that the auditor would be seen as a "representative for government agencies", a "police" officer or a "counter-party", rather than as a dialogue partner of the corporation. The existing crime-preventing contribution of auditors would thereby be undermined. In addition, unserious entrepreneurs could choose other associational forms ahead in order to avoid external auditing entirely. Secondly, the reporting requirement was said to be external to the auditors' natural competences, forcing them to make criminal

law judgments. Thirdly, the duty would be counterproductive also if generating a large number of reports containing suspicions of less severity, since the prosecutors were already overloaded with crime reports. Fourthly, there was a risk that the regulation would undermine the international credibility of Swedish business, and be an obstacle to the international harmonization of auditing – note that this critique took place before the “post-Enron” regulatory debate and reform (cf. Baker 2004; Dewing and Russell 2003; Ronen and Berman 2004). Also, in contrast to the British and American professions, the Swedish accountancy bodies did not effectively forestall the regulation by establishing stronger self-regulation with guidelines to uncover fraud and irregularities (Humphrey et al. 1993; Sikka et al.1998; Sikka and Willmott 1995; Tweedie 1991).

Institutionalizing distrust to create trust

Auditors are in the business of trust. Corporate financial auditing was established in the nineteenth century to secure the information needed by stock owners to decide on investment. The risk of bankruptcy and fraud was considerable, and the investors needed someone to verify that corporate financial statements could be trusted (Chandler et al. 1993; Sjöström 1994: 29ff.). This is still a primary aim of auditing, but in relation to a wider circle of interested parties. According to the Swedish professional accountancy organization FAR, the purpose of the audit is to examine and form an opinion of the financial accounts and the management, thereby giving credibility to the corporation’s financial information and management in relation to owners as well as creditors, suppliers, customers, employees, and the state and local authorities (FAR 2000: 11ff.).

Auditors create and guard impersonal trust and public confidence, which makes it possible for actors to cope with the lack of personal control and trust in the modern market-based economy. From a market perspective, the audit thus may be seen as a "commodification of trust". Auditors produce a verification that aims to bridge the deficit of information which shareholders and other market actors have in relation to corporate managements (Oliver 1997; Macdonald 1995: 187ff.). From a regulation perspective, the audit rather represents an effective "institutionalization of distrust", creating trust in an anonymous market (Braithwaite 1998; Shapiro 1987; Zucker 1986).

Even though it may be seen as an institutionalization of distrust, the audit is dependent on a trustful relationship between the auditor and the client corporation. Without cooperation and trust from the client, the auditor will have a hard time fulfilling the assignment. This trustful relationship builds primarily on the auditor's personification of competence, discretion, care, social skill, character and conduct in relation to the corporation (Seal and Vincent-Jones 1997). Such professional performances are stabilized through the values of professionalism, the professional entrance control and ethical self-regulation, as well as on the external legal regulation and supervision of professional practice.

According to the conventional perspective, client trust and public confidence in auditors and auditing are based on the profession's competence, confidentiality and independence (cf. FAR 2000: 91ff.; Moizer 1991). Leaving the competence aspect aside, *confidentiality* is there primarily to secure client trust. The duty of client confidentiality guarantees that any information about the corporation stays between the auditor and the client – with the exception of the audit report. The auditor's professional confidentiality is what gives the auditor the access needed in "policing", "cleaning up" and "patrolling" the facts of the

corporation – that is, in detecting and correcting mistakes in the accounts, and purifying and censoring the economic information to be disclosed to external parties (Ericson 1989; Power 2003).

The *independence* of the auditor is a corresponding warranty for other parties that the auditor is not "captured" by the interests of the corporation (Sikka and Willmott 1995). Or by the state, for that matter, which was believed to be a significant risk according to the critique of the Swedish legislation in question (Larsson 2005). The "honest disinterestedness" of independence is what distinguishes auditing from consulting – and in the latter case from policing (Jeppesen 1998) [3].

The significance of auditing for different parties is related to their interests and the latent conflict of interest between them – signaled by the need for both confidentiality and independence. The auditor's intermediate position and function of securing trust, between parties with potentially diverging interests, undermines the possibility for the profession to maximize client trust and public confidence simultaneously (Brooks 2001; Sikka et al. 1998). The primary problem in extending the auditor's crime-controlling task lies therefore in institutionalizing distrust so that trust is maintained or strengthened, not weakened, between parties with diverging interests. This is, basically, the central point of all the critique of the auditor duty to report on crime in Sweden: that it creates a police role with which the external auditors are captured by the state interest; that the corporations will cease to cooperate as closely as before with their auditors, thereby reducing the possibility of correcting mistakes and wrongdoing; and that the international confidence in Swedish business will be damaged.

Secondly, there is a problem in that the effectiveness of such regulation is dependent on not damaging the trustful "contract" between the state and the profession: That the professionals uphold a public-regarding for ethics in exchange for a regulatory autonomy. If it distrusts auditors in contributing to legal observance in the corporations, the state may create a defiant reaction among them. An extended control in order to guard public interests may "backfire" if not accepted as legitimate by the profession. Thus there are strong reasons for the regulator to adapt the legislation to established professional values and roles, if the aim is to create effective legislation (cf. Parker 1997).

The auditors as third party and soft target

It is the auditors' position as third parties that make them attractive as a target for extended state regulation. A regulation that exploits their position, without subordinating them to government agencies, is not only economically attractive. It is a way of strengthening non-hierarchical circles of control with "semi-autonomous powers" checking one another (Braithwaite 1997; 1998). In the present case, this is done by delegating control tasks to an autonomous profession. Their assignment and trustful relations with the corporations give them a greater opportunity to detect irregularities and intervene at an early stage, in comparison to external supervisory control (cf. Ayres and Braithwaite 1992: 158ff.).

According to Ayres and Braithwaite (1992: 54ff.), such "tripartism" may also be a way of avoiding regulatory capture. They are primarily referring to the involvement of public interest groups, and the accountancy profession is periodically criticized for having strong commitments to industry. Nonetheless, as a profession, auditors do have strong autonomy and

independence (Braithwaite 1997: 237). In Sweden this position is formally recognized in the long tradition of defining the audit as a protection not only of the interests of the corporation and the owners, but of the investors, the public and the state as well (Sjöström 1994: 79-92). Miethe's studies of whistle-blowing at work in the USA demonstrate that many auditors take on such a third-party position. According to his data, external auditors are not only in the top of occupational groups observing misconduct and reporting it internally. External and internal auditors are also well represented among those reporting misconduct externally (Miethe 1999).

The auditors may be seen as a third party in that their interests are different from the interests of the corporations and the state, and that they are subjected to other regulations and controls circumscribing their activities. Their professional organizations are a central constituent, as they are in charge of ethical self-regulation and disciplinary control. The international quality control in big accountancy firms and networks is another aspect of this control. In addition, the professionals are externally controlled by supervisory organs with disciplinary sanctions in their hands. Another layer of control consists of the media attention to corporate and auditing failures (Donabedian 1993).

It seems obvious that the primary aim for state control of economic crime should be to hold responsible those who commit such crime. However, there may also be reasons to control other actors in the corporation (Fisse and Braithwaite 1993: 218-221; Braithwaite 1997: 227ff.). One reason is that some corporations, directing managers or members of the board will not be deterred by criminal law. They are too "hard targets" to discourage with legislation and control. In such cases it may be most efficient to target other actors who have less to win and more to lose by breaking the law [4].

> The shameless chief executive may have a chairperson who is highly sensitive to his or her own reputation and the reputation of the organisation he or she heads. There may be an accountant who takes pride in his or her reputation for ethical conduct. No large criminal sanctions may be needed to prod such actors to take steps which are in their power to prevent organisational crime from occurring. This is important because, while only a small number of people may be involved in committing a corporate crime, a much larger number of people usually have the power to prevent it. (Fisse and Braithwaite 1993: 219f.)

"Soft targets" are actors that can be deterred even by the shame that a disclosure would bring, irrespective of their being held criminally responsible. An effective system of regulation and control utilizes such actors too, in order to produce law-abiding corporations (Ayres and Braithwaite 1992: 33ff.). For auditors and other potential "whistle-blowers" to be successfully mobilized for control tasks, there must be some institutionalized protection for them with formal channels for reporting (Bhojani 2002; Miethe 1999). The Swedish legislation is a means of creating such an institutionalization. It both obliges and protects auditors as semi-external whistleblowers reporting not only to the management and the board but in extreme cases also to the public prosecutor.

The Swedish legislation contributes in making the auditors into "soft targets". First, the low level of suspicion at which the duty to report comes into force, together with the fact that the auditor cannot be held responsible for damages if misjudging criminal law provisions, minimizes the economic risk in reporting. Secondly, the risk of being held liable for damages and subjected to disciplinary sanctions if neglecting to report increases the economic and professional risk in negligence.

A responsive regulation

A way of reducing the risk of client distrust is to make this kind of regulation *responsive* – that is, making the control and reporting requirement open for constructive dialogue and compliance through "Tit-For-Tat" strategies, rather than prescribing a mechanical reporting procedure aiming at deterrence (Ayres and Braithwaite 1992: 40f.) [5]. The civil law character of the legislation provides such an option. The client may choose to report the crime or rectify it. The regulation can thereby be seen as giving the auditors more power to make the client correct mistakes and offences. When provided with a legitimate channel to the criminal law sanctioning system, the auditors may escalate their measures in cases of non-compliance (Braithwaite 1998).

According to Ayres and Braithwaite, there are great advantages for crime-prevention efficiency in creating such a possibility of "Tit-For-Tat" strategies. However, as pointed out by the Swedish Office of the Prosecutor-General and its Division for Special Cases in the statement of opinion on the Government Inquiry Commission report, such a regulation is problematic in that it opposes central principles of criminal law and gives the offender time to remove the traces:

> Once a crime is completed, e.g. a big embezzlement, it cannot be "unmade" by the offender returning the unlawfully acquired funds. With such a solution, crimes in business would be favored in cases where the offender has the economic or other prerequisites to undo the harm. (Justitiedepartementet 1997:19 [translation])

Professional consequences and legal effects of the duty to report

From public statements and interviews with representatives of the Swedish professional organizations FAR and the Swedish Association of Auditors (Svenska Revisorsamfundet, SRS), it is clear that the negative stance towards the legislation has been softened. Partially, this has to do with the attempt by the legislator to adjust the regulation to the auditor's role and task (Engerstedt 2002; Holmquist 2000; Strömqvist 2000). This is verified by the postal inquiry survey. Half of the 694 respondents (47 percent) were very negative at the time of the enactment, 1999. By 2003 only a third of them (34 percent) still are.

The interview studies show that the critique among practicing auditors follows the same line of argument as did the statement of opinion prior to the enactment. First, the duty to report crime is viewed as inappropriate and uncomfortable in relation to the professional identity. Auditors are not keen on being perceived as "a prolonged arm of the prosecutor" or "government agency representatives". If the auditor were given such a "police role" and made into a "cleaning-woman", it would give people a wrong impression of what the auditor does. This is confirmed in the survey by the fact that only 11 percent of the respondents found that the reporting requirement suited their assignment.

Secondly, the duty is criticized for bringing new tasks exterior to the auditor's traditional competence and responsibilities. Several respondents in the interviews are not familiar with the details of the legislation, and do not believe their colleagues to have the competence and knowledge required in matters of criminal law. Of the survey respondents, 24 percent confirm this lack of adequate competence. The interviews show, however, that this is a marginal problem, since the auditors know which internal or external juridical expertise to consult in

such matters. Parenthetically, it is worth noting that the Economic Crimes Bureau has enhanced the option for auditors to discuss critical cases with prosecutors anonymously. Furthermore, 65 percent of the respondents state that they have taken part in further training concerning the duty to report.

Thirdly, the interviews confirm that many auditors see the reporting requirement as an infringement on confidentiality and autonomy, thereby undermining their client relations. By and large, however, this belief is not anchored in personal experience. It is rather a fear that client trust will wither in the long run, even though they have not seen any sign of that yet. On the contrary, a majority of the respondents state that the legislation has had no effect on their client relations. This is confirmed by the survey. Only 5 percent of the respondents have experienced a decrease in information from any of their clients, and only 2 percent have had clients expressing distrust because of the reporting requirement.

Fourthly, there is a concern in some interviews that the legislation will increase the "expectation gap", by causing the public to anticipate that auditors will detect more crimes than before. Other respondents point out that the belief in auditors detecting crime was already widespread – a survey conducted by FAR in the early 1980s showed that such expectations were common among corporate managers (Damberg 1980).

The interview studies and the survey thus demonstrate that many practicing auditors are antagonistic to the legislation, but also that this critique is decreasing. There are many respondents expressing a view that the fears were exaggerated, since the changes were quite marginal in the end. Despite the massive critique before the enactment, 11 percent of the survey respondents state that the legislation in fact has strengthened their independence. In

addition, 5 percent of the respondents believed that the duty has reinforced the confidence in auditors from the public and other market actors.

Opinions on the crime-preventive effect

The Swedish National Economic Crimes Bureau (EBM) has announced that the legislation has shown a crime-preventive effect. The number of reports from auditors is increasing over time, and the reports submitted are of high quality. In an effort to evaluate the legislation, EBM conducted a survey according to which 17 reports were submitted by auditors during the first year since the enactment in 1999 (Ekobrottsmyndigheten 2000). In a corresponding survey covering 2003, the number of submissions from auditors was 41 (Ekobrottsmyndigheten 2004a). These numbers are of course remarkably small, compared to the number of reports from the taxation authorities, which were over 1,800 during 1999 and over 2,800 during 2003. The corresponding number of reports from receivers in bankruptcy and from the enforcement administration was nearly 3,000 for both these periods (Ekobrottsmyndigheten 2004b:55). It should be noted, though, that these figures are based on register data, whereas the number of reports from auditors comes from retrospective survey inquiries to prosecutors. Reports not leading to a preliminary investigation may have been left out.

These low figures have also been taken as testimony that the regulation is without significance. Such a claim is substantiated in the interview studies and the survey by auditors questioning the crime-preventive effect of the legislation. Only 16 percent of the survey

respondents believe that the reporting requirement has any crime-preventive effect, and 34 percent state that it is practically unproductive.

Three reasons are given for why there is little crime-preventive effect – and indirectly for why there is little change in client relations. The first is that the audit has not been affected by the legislation. The basic crime-preventive effect in detecting and correcting errors and mistakes was there even before the legislation, but conducted in more “informal” and “flexible” ways.

Another reason is that there is little knowledge of the legislation among the client corporations. This is partly because auditors and accountancy firms choose not to inform their clients about the reporting requirement. Only 5 percent of the survey respondents believed that clients in general know of this obligation, and only 7 percent had made it a routine to inform their clients. This tendency is confirmed by interviews in which the respondents expressed a fear that client trust would decrease if knowledge about the duty were spread. Such worries were held only by a minority of the survey respondents, however. Around 15 percent of them believed that it would damage the firm’s reputation and their trustful relation to other clients if they were to report one of their other clients.

The third reason why the legislation has minor crime-preventing effects, and why the client relations were unaffected, concerns the differentiation between serious and unserious clients and auditors. A recurrent theme in the interview studies is that serious entrepreneurs are not bothered by the legislation, and that the respondents have no experience of lighthearted or criminal entrepreneurs. They avoid such clients, or critical lines of business at large. And such criminal clients are said to seek out less serious accountancy firms and auditors, or to utilize other forms of association so as to avoid external auditing completely.

The regulation put into practice

The picture gets somewhat more complex when focusing on the practical application of the legislation. In contrast to the critique, some respondents state in the interviews that the duty has given them a helpful enforcement instrument in making corporations correct errors and irregularities. It is viewed as a strength of the regulation that auditors were obliged, and not only given a right, to report. The survey shows that the duty really is put into practice, yet with strong precautions, or perhaps better in a "responsive" way. For one thing, the focus on crime and irregularities has increased. Many firms have established routines to handle critical cases, and a significant number of auditors have conducted extended controls and employed the duty to report to put pressure on a client. In addition, many have become more cautious in choosing clients. Still, only a small number of auditors in the survey have actually submitted a report to the authorities.

As noted above, the audit is said by many interview respondents to be practically unaffected by the reporting requirement. Nevertheless, 12 percent of the auditors in the survey have changed the planning and process of the audit. These changes consist primarily of an increase in attention to crime, but also of new elements in the "checklist" or audit program. This change is confirmed in interviews by respondents talking about extra efforts made in deviant or gray-zone cases.

Other minor changes are made on a broader front. Of the respondents, 67 percent state that their firm has specified what internal or external expertise to consult if a suspicion of crime

arises. In addition, 44 percent of the firms have established internal routines concerning how to handle such suspicions. From both the interviews and the survey, it is evident that many auditors have become more cautious in choosing their clients because of the reporting requirement. This is stated by 36 percent of the survey respondents. And even though the majority of the respondents choose not to inform their clients routinely, 47 percent of them have informed a client of their obligation to report in order to put weight behind a remark. Further, 42 percent of them have made extended controls or have consulted a colleague or lawyer concerning a suspicion of crime.

Only six percent (44) of the auditors in the survey have submitted a report to the public prosecutor. Considering the discomfort in becoming an “official”, the argument concerning unserious clients and auditors, and the difficulty in judging the strength of the suspicion, it is not surprising that many auditors prefer to make the board report or rectify the crime. Such a strategy is also in line with the aim to strengthen the crime-preventing role of auditors. A problem, however, is that the two weeks’ respite is considered too short, and that the level of suspicion prescribed is too low. Some auditors state in the interviews that they are willing to stretch this period of time, and some that they will not report unless they are certain that a crime is committed. This is confirmed by the survey, through a hypothetical question concerning the respondents’ “reporting-threshold”. A majority of the respondents (80 percent) estimate that they have to be certain to a degree of at least 75 percent before reporting, and 30 percent of them place this threshold at a level over 95 percent. This reluctance is also verified by the unease of reporting expressed in some interviews, and by the fact that some auditors find it pointless to report since the prosecutors are overburdened and will not bother about weak cases.

Conclusions

A first conclusion is that the question concerning client relations is too narrowly stated to grasp the professional consequences of the legislation. The analysis above shows that the issue for the professionals concerns their self-identity and competence, as much as changes in the clients' expectations or trust. Many auditors feel uneasy over the duty in relation to the professional role with which they identify. In addition, they worry about a change in their clients' conceptions – that they will be viewed as "officials", "police", "informers" or "whistle-blowers". Furthermore, many auditors experience a pressure now upon them to acquire new competence in matters of criminal law.

In contrast to such fears, very few auditors report any losses in client trust or significant changes in client relations because of the regulation. Still, 5 percent of the survey respondents had experienced that the information from a client decreased because of the legislation. This seems to be the most important negative consequence. In addition, a somewhat larger group of auditors believe that this effect would be stronger if the legislation were to become better known to their clients.

There are several reasons why the negative stand against the duty to report is decreasing in the auditing professions. The first is the civil law construction of the reporting requirement. Together with the responsive elements, it cut off the sharpest edges in fitting the duty to report into the existing professional role. By giving an opportunity for constructive dialogue and rectification, it provoked less change in the client relations than was feared.

Secondly, there was less negative effect of the legislation on client trust than expected. This is partly because of the lack of knowledge in the corporations, and partly because they do not believe such a task to be something foreign to the audit – rather the existence of an "expectation gap" implies that auditors already were believed to include in their task the detection and reporting of crime (Damberg 1980; Sikka et al. 1998).

Thirdly, the profession has an interest in rapidly "renormalizing practice", in order to restore credibility in the wake of the controversy that the duty to report on crime caused (cf. Power 2003). This is done both by downgrading the significance and effects of the legislation, and by not informing the clients. In the extreme case, this may be a strategy of "creative compliance" diminishing the effects of the legislation. There are some statements in the interviews and the survey that may be interpreted accordingly: that one cannot accept the low level of suspicion at which the duty comes into force; that confidentiality comes first; and that the duty to report "is sleeping quietly". The differentiation between serious and unserious auditors made in some interviews also points to the fact that some auditors are "hard" rather than "soft" targets. They will not be enrolled for such a control assignment. Still, there is no evidence that such a stance is widespread.

Hence, the auditor duty to report suspicion of crime is an institutionalization of distrust that has not damaged trust, at least not to any wide extent. But can it be said to enculture or reinforce trust? Only a minority of the practicing auditors believe that public or market confidence in auditing is strengthened by this legislation. The public knowledge of auditing is generally low, and the knowledge of the duty to report on crime is most likely even lower. With the existence of an audit expectation gap, the significance of the legislation lies rather in

decreasing the risk of future losses in public confidence, caused by a realization that auditors did not have the expected task of detecting and reporting crime.

The trust-building effect of the legislation is therefore primarily indirect. The duty to report on crime may be seen as a symbolic resource that the profession can utilize when questioned because of accountancy scandals or corporate frauds. The duty to report on crime can be used to emphasize that the negligent auditor is an exception – that is, if there is evidence that the majority of the profession complies with the reporting requirement and contributes to the control of economic crime. The legislation may in such cases be used to relieve the profession from "collective guilt" in times when the question is raised of where the auditors were (Daniel 1998). The obligation to report may also protect the individual auditor in critical situations. In contrast to a right to report, an obligation brings less risk of pressure from the clients. And the auditor is given a legal option to blow the whistle and thereby avoid being dragged down with the client (cf. Miethe 1999: 91ff.)

Also on the question concerning the crime-preventive effects of the legislation, the results point in two directions. This really should come as no surprise, since auditors cannot be expected to act completely homogeneously. The auditing profession is segmented and professionals are, as individuals and in spite of the existence of a "professional project", committed to different values and subjected to different economic and organizational circumstances (cf. Parker 1997).

On the one hand, some facts seem to indicate that the legislation is "disarmed" though creative compliance. The reluctance to inform clients, to break client confidentiality, and to report at the low level of suspicion prescribed, as well as the readiness to stretch the two

weeks' respite given, may be interpreted in such a way. In addition, the total number of reports submitted is remarkably small, and many auditors state that the legislation has no crime-preventive effect whatsoever.

On the other hand, the survey demonstrates a widespread "responsive" utilization of the duty. Even if there are doubts about the crime-preventive or reporting effect, the law obviously is used in focusing on wrongdoing and irregularities and making corporations comply with reminders from the auditor. A majority of the auditors in the survey have engaged in further training because of the reporting requirement, and there has been an increased focus on crime and irregularities. Half of the respondents have made extended controls, and half have informed a client in order to put weight behind a reminder, and almost as many have consulted juridical expertise regarding a suspicion. The preparations made to extend the respite for submitting a report to four weeks should be seen in the light of such a responsive practice, in which the contact with the criminal law sanctions is a last measure to be used only against non-complying corporations.

The "narrow sector" in Swedish economic crime control is said to be the public prosecutors, since they lack enough resources to follow up all crime reports (Korsell 2003: 106ff.). For that reason, it may not be a great failure if the auditors submit only a few reports of high quality. The auditor duty to report on crime is only complementary in relation to other crime control, and the aim is primarily preventing crime, not detection. There may even be reason to accept that there is another wide "expectation gap" to consider: that between the expectations of a new regulation and the actual possibility for regulators to control professionals and corporations (Paterson and Teubner 1998; Power 1993).

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Notes

[1] The total population of qualified (authorized or approved) auditors in Sweden in 2003 was 4,146. The majority were organized in two professional associations from which a random sample of 1,350 respondents were drawn. FAR (previously Föreningen Auktoriserade Revisorer, the Swedish Institute of Authorized Public Accountants) organized 2,520, primarily authorized, auditors. Svenska Revisorsamfundet SRS (the Swedish Association of Auditors) organized 1,391 auditors, specializing in auditors at medium and small companies. The postal questionnaire was sent out during the fall of 2003 and the response rate was 52 percent (net). A non-response analysis shows good representativeness in terms of gender, membership in professional association (FAR/SRS), and degree of authorization (authorized/approved). Detailed accounts of the sample are given in Larsson (2004).

[2] These 30 studies are all theses for bachelor's or master's degrees in Business Administration. They are primarily based on interviews (face-to-face or by telephone). The material also includes two minor postal/mail survey inquiries covering 99 auditors and 16 accountancy firms. The papers are of somewhat varying quality, but generally well focused on the experiences and consequences of the auditor duty to report on crime. Altogether they attest a great variation in opinions, but some tendencies are recurrent and these are emphasized in the analysis. For a detailed listing of the 30 theses, see Larsson (2004).

[3] In the theory of professions this independence from the state, and the capacity of a profession to act as a self-regulating body, are often spoken of as "autonomy" rather than as "independence" (Macdonald 1995). Still, in individual practice it can be said to be an aspect of the auditor's independence from the interested parties.

[4] I would like to thank Lars Korsell for specifically pointing out the relevance of these concepts in analyzing the legislation in question.

[5] The game-theoretic conceptualization of the TFT strategy is that "a prisoner's dilemma player cooperates until the opponent defects and responds by defecting until the opponent cooperates." (Ayres and Braithwaite 1992: 62)