Aalto University
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The Development and Harmonization of the Audit Report - Evidence from Europe

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Abstract
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PURPOSE OF THE STUDY

This paper discusses the main changes in national and international auditing rules and regulations that have affected European countries. The theoretical part of this paper discusses cultural frameworks, corporate governance and auditing as a part of its control mechanisms. These dynamics will be reflected to changes in audit reports in four carefully selected countries, Finland, France, Germany and United Kingdom. The empirical part of the paper measures the level of harmonization within and between these countries.

DATA

The study will be based on domestic and foreign literature on legislation and accounting rules and regulations. Audit reports will be collected and analyzed from four European countries, Finland, France, Germany and United Kingdom during ten years, 2000-2009.

RESULTS

Strong national dynamics affect the diversity of audit reports; however, the study shows a trend towards harmonization during the ten observed years. The audit reports show increasing comparability nationally and internationally. The mandatory applications of the IFRS standards and the Eight Directive have had a notable effect in audit reporting.

KEYWORDS

Auditing, audit report, auditing standards, international harmonization, C-index.

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TILINTARKASTUSKERTOMUKSEN KEHITYS JA YHDENMUKAISTUMINEN– AINEISTOA EUROOPASTA

TUTKIELMAN TAVOITTEET

Tämä työ käsittelee suurimpia muutoksia kansallisissa ja kansainvälisissä tilintarkastussäädöksissä, jotka ovat vaikuttaneet Euroopan maihin. Näitä muutoksia peilataan muutoksiin tilintarkastuskertomuksissa neljässä kohdemaassa: Suomessa, Ranskassa, Saksassa ja Isossa-Britanniassa. Työn teoreettinen osio käsittelee kulttuuriviitekehyksiä, hyvää hallintotapaa ja tilintarkastusta sen eräänä kontrollimekanismina. Empiirinen osa mittaa yhdenmukaistumista näiden maiden sisällä ja välillä.

LÄHDEAINEISTO

Työ perustuu kansalliseen ja kansainväliseen lainsäädäntöön ja tilintarkastussääntöihin. Tutkimuksessa käytetään otoksena kahtakymmentä listattua yritystä, joiden kotipaikaksi on merkitty jokin neljästä edellä mainitusta Euroopan Unionin valtiosta. Aineisto koostuu näiden yritysten tilintarkastuskertomuksista vuosilta 2000–2009, jolloin otoskooksi muodostuu 200 kertomusta.

TULOKSET

Tulokset osoittavat, kansalliset instituutiot ovat vaikuttaneet tilintarkastuskertomusten erilaisuuteen. Näiden vaikutus on kuitenkin vähenemässä, sillä merkittävät muutokset lainsäädännössä ja raportointiperiaatteissa ovat lähentäneet eri maiden tilintarkastuskertomuksia niin kansallisesti kuin kansainvälisestikin. Erityisesti IFRS:n ja 8. Direktiivin pakollinen käyttöönotto on vaikuttanut suuresti yhdenmukaisuuteen.

AVAINSANAT

Tilintarkastus, tilintarkastuskertomus, kansainvälinen yhtenäistäminen, indeksit.

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1 INTRODUCTION

1.1 Background and Motivation

Differences in national accounting and auditing principles stem from variations of culture, business conduct, taxation and the level and pace of economic activity. (Barley & Haddad, 2007; Troberg, 2007; Whittington, 2008) These accounting systems evolve, reflect and reinforce the economic environment they serve. Thus, the international accounting system is a collaboration of the globalization of financial markets and the international economic integration. (Barley & Haddad, 2007; Gangolly et al., 2002) Globalization has increased the need for companies to be listed in several financial markets, which is crucial in order to increase transparency and earn credibility as an operator in the financial market. This trend will unquestionably continue over the following years. (Combarros, 2000)

However, globalization has raised yet another issue, the lack of harmonization resulting in that this process has encountered a variety of accounting principles and standards that have created a barrier not easily understood by investors and companies (Combarros, 2000). According to Barley and Haddad (2007), international accounting harmonization is a by-product of the new economy and IT. Consequently, there is a growing need for cross-national understandings of corporate financial reports and inter alia, audit reports (King, 1999). As it is, differences still exist in accounting and auditing policies even inside the European Union, despite long-term attempts of their harmonization. The differences derive from various national dynamics, e.g. culture. According to this view, accounting systems reflect particular assumptions about rationality, authority, time, organizations and so forth (Dent, 1991).

The Fourth Directive on Company Law enacts the requirement of giving a 'true and fair view' on financial reporting in all of the Member states of the EU. As such, the auditor's report should include an opinion whether this 'true and fair view' is achieved in the financial statements. Therefore, the auditor's report is a primary tool for auditors to communicate with financial statement users and thus its development and harmonization is of utmost importance. (Van der Tas, 1988; King, 1999; Gangolly et al., 2002) All Member states have some type of Company Law that describes the form and content of the annual reports to which the auditor expresses an opinion. However, the manner in which professional standards are enforced will have an impact on the form and content of the audit report. As such, harmonization is of high value in order to decrease information asymmetries and other inefficiencies in the market as well as increasing the credibility of financial reports. (Troberg 2007, p. 20).

During the past 10 years, Europe, along with the rest of the world, has seen various changes and new policies. A series of high-profile accounting frauds all over the world shook investors' confidence in the integrity of financial reporting. These scandals drew increased attention to accounting and auditing policies and augmented the need for transparency and integrity. To re-establish the investors' and other stakeholders' trust, a series of regulatory initiatives and changes have taken place on international, regional and national levels. These include new OECD restrictions, the application of IFRS as well as the International Standards on Auditing (ISAs), set by the International Assurance Standard (IAASB). (Eilifsen et al. 2010, p. 4) In addition, there have been initiatives to harmonize accounting and auditing policies and standards. What the extent of harmonization should be and how far it has really come is however still unknown.

Research on accounting and corporate governance in an international setting has been rather extensive. It seems that the main accounting standard setters, namely FASB and IASB, have started a transition towards a common set of accounting principles. According to Whittington (2008), more than 100 countries now recognize international standards for some purpose. In addition, along with the European Union and Euro, harmonization has set its foothold in most business practices in Europe. This means that accounting policies will have their fair share of harmonization. Some work has already been done towards a more congruent future. "One of the priority objectives of the European Union is to enhance the completion of a single market with free movement of capital, the establishment of an integrated financial services and securities market operating with a single currency" (Combarros, 2000). A recent initiative towards this unity has been the mandatory application of IFRS standards in all listed companies within the EU since 2005.

Accounting literature has mostly focused on the harmonization of accounting practices used in the preparation and presentation of financial information. Despite the extensive research on international accounting, there has been less research concerning international auditing or audit reports in particular. There have been quite a number of studies on international harmonization, but they have focused on international standards, corporate governance or financial reporting in general. A number of studies have been conducted to compare national audit practices and audit institutions. Similarities and differences in international financial reporting have also been a focus of prior research. (e.g. Maijoor et al., 2000; Baker et al., 2001; Francis et al., 2009) These studies have mainly focused on the differences between audit reports and audit practices, and also on the meaning of the true and fair view. However, only few studies have dealt with the international harmonization of the audit report, although the audit report is said to be a key communication tool for auditors. King (1999) measured the harmonization of the form and content of the audit report in European countries during the year-end of 1995/1996 annual reports. He compared the national audit reports to the Auditor Report ISA, which had just been issued. Gangolly et al. (2002) studied the harmonizing effect of the application of the ISA 13. However, they only had two time frames, pre-implementation and post-implementation.

The lack of exhaustive studies in audit report harmonization provides a fertile ground for a study that compares audit rules and reports nationally and internationally. The study at hand adds to the theoretical framework as it evaluates the harmonization and development of audit reports in a longer time period and takes into account as many auditing regulations as possible. In addition, it presents the application of the C-index into the measurement of harmonization of the elements of the audit report. Previously, the C-index has been used only in studies of the treatment of certain accounting methods.

1.2 Objectives and Limitations

The purpose of this paper is to describe and explain how the recent changes in legal and professional practices have affected the development of the audit report in four example countries; Finland, France, Germany and the United Kingdom. In addition, the paper will look into the harmonization within and between these countries. The aim of this study is to define the main dynamics that have affected the change within the audit reports during the years 2000 – 2009 and create a framework based on the analysis. These years were chosen, as they include many interesting events that have had an important impact on the development of accounting rules and regulations. One of the most profound of these incidents was the series of big accounting scandals in the beginning of the 2000s. The collapse of WorldCom and Enron among others drew attention towards transparency and better monitoring of financial reporting. Another important initiative during this timeframe was the mandatory implementation of the International financial reporting standards (IFRS) in 2005 and the introduction of the EC Directive concerning the statutory audits of annual and consolidated accounts, 2006/43/EC. In addition, the year 2000 was selected as the first examined year due to limitations of data. Only few companies provide financial information prior to year 2000 on their websites.

The research will focus on four European countries, Germany, France, Finland and the United Kingdom. The selection of the countries is based on their legal and cultural environments, following the law and finance approach. According to this approach, countries can be divided into two groups based on the legal tradition of each country. These groups are common law countries, in which United Kingdom is fitted into, and civil law countries, in which the other comparison countries are categorized to. (La Porta et al., 1998; López-de-Foronda et al., 2007). The countries also differ on their reporting regulations and practices, reasons to which will be examined. Thus, one could expect that these countries have different auditing traditions, which reflect the audit reports. In the light of these differences, it can be expected that the harmonization within EU could be seen by comparing these countries. With the help of empirical research, a theoretical framework will be constructed on the main dynamics affecting audit report development and harmonization.

The main research issues can be defined as follows:

1) What are the main changes that have occurred in audit reports in Germany, Finland, France and United Kingdom during the past 10 years? Why are they so different in the first place?
2) What are the main forces that have driven these changes?
3) What is the level of harmonization of audit reports in and between the four countries?

In order to find answers to these questions, one must research the cause-and-effect relationships of the changed national and international regulations. However, one of the main limitations of the research is the amount of data. In order to measure harmonization thoroughly, all Member States of the EU should be examined, which is too laborious for the scope of this paper. Another limitation may be the availability of the audit reports and matching the changes in them to the actual causes. National regulations vary in the disclosure of annual statements of previous periods. In addition, the translation of audit reports into English may provide some distortion to the research, as some companies may add comments according to the US GAAP for instance. These additional comments may be added to provide information to foreign investors according to regulations they are more familiar with. Further, the analysis will be carried according to the information provided in the auditor's report, which may cause some bias as the results and conclusions are based on 'what auditors say they do' which may not always equal 'what they actually do'.

1.3 Research Method and Structure of the Study

The research will be conducted through a comparison of audit reports from the four aforementioned countries. Their main features will be analyzed as a comparison to each other nationally and internationally during a time frame of 10 years. Due to limited resources, only audit reports in English will be assessed. These audit reports will be acquired from five listed companies in five different industries in each country resulting in a sample size of 200 audit reports. The reports will then be quantitatively analyzed in order to measure how they have changed throughout the years. The data will be processed with the help of the C-index to measure comparability and harmonization of the audit reports.

After the construction and application of indices, the differences found will be compared to changes in national and international regulations. To discover main changes in a country's audit reporting patterns, one must go through the development in legal, cultural and other environments. The European Union has also set new principles and standards, which surely have affected the conduct of business in the Member states. Also new trends, such as a heightened interest in corporate governance and transparency have left their mark. In order to reach the goal of the study, one must conduct an analysis of relevant literature from the field of accounting and auditing as well as study international and national regulations. The main purpose of the paper is to develop a framework of the main dynamics affecting the reporting of auditors.

The first three chapters of the thesis set the theoretic frame for the study. The first part discusses principles of corporate governance as well as corporate governance mechanisms. In a broad sense, auditing can also be seen as one of these mechanisms. In addition, it discusses the agency theory, which has often been referred to as one of the main motives for corporate governance. (La Porta et al. 1998; Edwards & Nibler, 2000) Further, this part discusses the importance of auditing and introduces the audit report, the main communication tool of auditors. The paper then moves on to introducing national dynamics and compares the four countries in the light of these dynamics. National audit institutions and regulatory environments are also discussed. As culture and national dynamics are elusive concepts, several frameworks are introduced to gain better knowledge of differences between the four case countries.

These national dynamics will be used later as an assessment of why some regulations and institutions have been developed as they have. It can be expected that certain dynamics have affected the development of national reporting requirements and practices and thus resulting in differences between countries. Based on the theoretical part of the paper, a framework will be built. This framework will be used in the analysis of the empirical results and later updated based on the findings. The third part of this paper discusses the harmonization of financial reporting and auditing requirements. The section begins with a definition of harmonization, moving on to discussion of its different elements. These elements are the basis for the indices. The chapter discusses the main initiatives towards harmonization and changes in audit regulation.

The empirical part of the paper discusses the research design and construction of indices as well as presents the results of the empirical study. It discusses the legal and regulatory environments of the four chosen countries and presents empirical evidence received from the research of audit reports. This evidence is then reflected with the theoretical findings of this paper. Based on this comparison, the framework will be updated to better depict the cause-and-effect relationships of the main dynamics that have affected the development of the audit reports. The last section of this paper discusses the main findings and draws conclusions on the study. It also provides suggestions for further research. The appendices present national audit regulation in more depth.

1.4 Definition of Main Concepts

Corporate governance "consists of all the people, processes and activities in place to help ensure proper stewardship over an entity's assets. Good corporate governance ensures that those managing an entity properly utilize their time, talents and the entity's resources in the best interest of owners and other stakeholders, and that they faithfully report the economic condition and performance of the enterprise." (Eilifsen, 2010)

Auditing "is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users" (Eilifsen, 2010)

Audit report Issuing the audit report is the final phase of the auditing process. The audit report communicates the auditor's findings to the various stakeholders of the company and users of its financial statements. The most common type of the audit report is the one with an unmodified opinion. Deflection of this report is a strong signal towards the reader that the auditor has not received reasonable assurance of the company's financial statements. (Eilifsen, 2010)

C-Index was originally introduced by Leo van der Tas (1988) and further developed by Archer et al. (1995) as a method of measuring of accounting harmonization.

Harmonization 'is that process according to which an increase in the amount of accounting practices compatibilities is persuaded through delimiting a certain degree of variation" (Nobes & Parker, 2006). Harmonization can be further divided to *formal harmonization* depicting regulatory harmonization and to *material harmonization* depicting harmonization of financial reporting.

Statutory audit can be defined as "the external audit of company financial statements by a person or persons recognized by a nation state or government as being competent to carry out such audits" (Baker et al., 2010). The study will focus only on external audits, and the concepts 'statutory audit' and 'audit' will be used as synonymous in the paper.

2 IMPORTANCE OF AUDITING

Auditing has an important role in ensuring the validity of a company's financial reporting as an auditor adds credibility to company financial statements. Users of financial reports conceive the audit report as a guarantee of reliability. Thus, auditing has established a foothold of being an integral part of advanced capitalist economies. (Baker et al., 2010) This chapter will discuss the value of auditing from different angles beginning with an introduction of auditing as a part of corporate governance and its control mechanisms. The chapter will then continue to discuss the role of audit reports and how auditing processes and audit reports based on them may vary between countries. The final part of the chapter presents why the harmonization of auditing and audit reporting practices is of high value.

2.1 Corporate Governance Systems and Control Mechanisms

Corporate governance can be defined as "a set of mechanisms – both institutional and market-based – that induce the self-interested controllers (those that make decisions regarding how the company will be operated) of a company to make decisions that maximize the value of the company to its owners (the suppliers of capital)" (Denis & McConnell, 2003). Weimer and Pape (1999) define a system of corporate governance as "a more-or-less country-specific framework of legal, institutional and cultural factors shaping the patterns of influence that stakeholders exert on managerial decision-making". In addition, Heugens and Otten (2007) state that all codes of corporate governance in effect include some form of 'comply or explain' principle.

However, as La Porta et al. (1998) state, "there have been no systematic data available on what the legal rules are pertaining to corporate governance around the world, how well these rules are enforced in different countries, and what effect these rules have". Solomon (2010) agrees and suggests that categorization of corporate governance systems is at best a loose and at worst an incorrect oversimplified representation of a country's financial systems and thus there is no single accepted definition for corporate governance. Further, structures of corporate governance reflect cultural and legal backgrounds, and vary nationally (Eilifsen, 2010).

Despite the elusive nature of corporate governance, the Dichotomous worlds hypothesis claims that corporate governance systems worldwide are based on either the Anglo-American shareholder model or the Eurasian stakeholder model (Denis & McConnell, 2003). Heugens & Otten (2007) however, suggest a more fine-grained classification of corporate governance systems using five different logics: "Socially constructed, historical patterns of material practices, assumptions, values, beliefs and rules by which all parties involved in economic productive activities structure their material interdependencies and provide meaning to the social reality of corporate life". Weimer and Pape (1999) offer a third view with a division into four groups: Anglo-Saxon, Germanic, Latin and Japanese systems. They further elaborate that the debate on international corporate governance is being aggravated by the fact that the literature still lacks a framework in which these systems could be positioned in a methodical way.

Despite her critique against corporate governance categorizations, Solomon (2010) divides corporate governance systems according to an 'insider/outsider' model. Countries where publicly listed companies are owned and controlled by few major shareholders, such as Germany, France and Finland, are said to have insider-dominated or relationship-based systems. Countries where large companies face the separation of control and ownership are said to be outsider-dominated, market-based or Anglo-Saxon or Anglo-American systems, due to the influence of the UK and US stock markets on others around the world. (Solomon, 2010) However, as noted by the Cadbury report (1992), rules and structures alone cannot raise standards of corporate governance. Nevertheless, they are important because of the framework they provide, which will encourage and support good governance. Their enforcement and use are very important in this context.

López-de-Foronda et al. (2007) present that the operation of some corporate governance mechanisms is dependent on the quality and origin of a country's legal institutions. According to this view, manager ownership and firm debt are the most effective mechanisms in the Anglo-Saxon countries, whereas the distribution of ownership and control among shareholders is an important mechanism in Continental Europe. King (1999) agrees and states that the effectiveness of the mechanisms may be affected by the relationship within the firms and how the rights of shareholders are protected in each country. These differences will be depicted in more detail in Chapter 3. Corporate governance mechanisms are typically distinguished between internal and external mechanisms (Heugens & Otten, 2007).

Internal mechanisms consist of intentionally designed control instruments, which include categories such as the board of directors and managerial incentive plans (Denis & McConnell, 2003). Heugens and Otten (2007) suggest that there is a substitution effect between dispersed ownership and organizational design. This suggestion derives from the finding that greater attention is paid towards strengthening of internal mechanisms, where external ones have lost their effectiveness. They state that "this effect can be observed for the US and UK, with their traditional reliance on the market for corporate control, and for France, with its above-average appetite for state legislation".

Heugens and Otten (2007) suggest that external mechanisms are more of a mix between "deliberately designed and spontaneously evolved control instruments and include categories such as auditing profession and takeover markets." Denis and McConnell (2003) agree and present that when internal control mechanisms fail to a large enough degree, it sets an incentive for outside parties to seek control of the firm. Therefore, Ashbaugh and Warfield (2003) state in their study that: "external audits play a corporate governance role as a monitoring mechanism when there is potential for greater agency costs due to the separation of managers from a company's stakeholders". This role will be discussed next.

2.2 Auditing as an External Control Mechanism

Auditing has an important role in ensuring the validity of a company's financial reporting. The role is so strong that the Cadbury report (1992) perceives auditing as a cornerstone of corporate governance. This chapter will discuss the importance of auditing as part of the control mechanisms of corporate governance. It will begin with an introduction to the agency theory and asymmetries of information and how auditing can help in reducing them.

Agency theory derives from the separation of ownership and control. One of the basic assumptions of finance theory is that the primary objective for companies is to maximize shareholder wealth. There might be conflicts of interests, however, as different parties may want to achieve different goals. Owners want the managers to work as hard as profitably as possible but the manager may have a different agenda. If both parties thrive to maximize their self-interest, managers may not act in the best interest of the owner but rather in a manner of 'egoism'. (Eilifsen, 2010; Solomon, 2010) These conflicts of interest are usually combined with the inability to write perfect contracts and/or monitor the controllers with low costs. These issues together may ultimately reduce firm value, which is rarely the goal of the owner. (Denis & McConnell, 2003) This raises the question of how can entrepreneurs, shareholders and managers minimize this loss of value resulting from the separation and ownership.

One solution is that the manager should provide the owner financial information according to some set of agreed-upon standards. Thus, accounting and auditing have an important role in reducing agency costs by providing the principal trustworthy information on the company's performance. However, reporting financial information according to accounting principles is not sufficient in itself to solve the agency problem. As the manager is in charge of providing this information, he/she is in a position to manipulate these reports, a process which the absentee owner cannot directly overview. In order to monitor that the financial reports conform to the agreed-upon accounting principles, an auditor evaluates their fairness. Auditing reduces the agent's possibilities to manipulate the financial information, adding up to its credibility and thus reduces information risk. Moreover, it seems that auditing is a cost-effective monitoring device. (Eilifsen, 2010; Solomon, 2010)

Therefore, auditing helps to ensure that information is understandable, relevant, reliable and timely (Eilifsen, 2010; Cadbury report, 1992). However, to be able to ensure investor confidence in financial statements, it is crucial that the auditor is free from influences that would obstruct his/her ability to detect and eliminate management bias in the preparation of the statements, i.e. is independent. The requirements for independence and definitions of what is perceived contradictory to the auditor's ability to conduct his/her duty vary between countries. Auditor independence is key in the decisions of client acceptance and continuance of auditing existing clients. (Francis et al., 2008).

The objective of auditing is to provide reasonable assurance that the financial statements are free from material misstatements due to fraud or error. The concept of 'reasonable assurance' used in the audit report relates to the auditor's responsibility to inform the reader that there is a risk that the audit may not have detected all material misstatements. Further, it usually is impossible and furthermore irrational to go through all of the audit evidence. The concept 'material' is used to refer to "misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both." Further defining, "a misstatement, due to error or fraud is a difference between the amount, classification, or presentation of a reported financial statement element, account or item and the amount, classification or presentation that would have been reported under the applicable financial reporting framework." (EIlifsen, 2010)

Auditing provides a number of benefits. The auditors add credibility to financial reports by using their knowledge and expertise, although they cannot guarantee the credibility (Troberg, 2007). Thus, they serve to reduce the risk of asymmetric information (e.g. Ashbaugh & Warfield, 2003; Edwards & Nibler, 2000). Audits add to the effective functioning of financial markets and also to the effective operation and monitoring or companies. Further, they serve to keep an eye on management, contributing to companies' overall corporate governance and thus protecting shareholders' interests. Moreover, audits play an information role when the audit report provides assurance to external stakeholders that firms are viable going concerns. (Gassen & Skaife, 2009) It is even argued that audits reduce the cost of capital (Burns & Fogarty, 2010).

Companies, which are included in the scope of the Fourth Directive, must have their annual accounts audited by one or more persons authorized by the national law to audit accounts. However, small companies may be relieved from this obligation. According to the Fourth Directive, auditors are appointed in the general meetings. In addition, they are entitled to reappointment, although it requires a fresh decision from the general meeting. Natural persons or firms of auditors can only be appointed as auditors if they are not engaged in an activity which is incompatible with the statutory auditing of the accounting documents under the law of the Member State (Eight Directive).

According to Burns and Fogarty (2010), audits are a collection of judgments on various matters, including management's application of accounting pronouncements, adequacy of management's disclosure, scope of the audit, risks of misstatement, materiality and sufficiency and appropriateness of audit evidence. In general, the main phases of an audit include accepting the audit client, audit planning, test of controls and substantive tests, analyses and interpretation of evidence and audit reporting. The whole process should be conducted according to the same auditing standards. (Troberg, 2007)

2.3 Varying Auditing Standards

Auditing standards serve as guidelines for determining what an audit is, promoting consistency, providing a means to judge audit performance and influencing auditor behavior. They also set the tone and the basic outline of the judgments and actions that make up an audit. "The development and existence of appropriate, high quality auditing standards is the first step in the road to quality audits" (Burns & Fogarty, 2010). Auditing standards have several important purposes, such as defining what an audit is, promoting consistency, providing a method to judge performance and facilitating education. Furthermore, audit standards affect auditor behavior through means of inspections, enforcement and firm methodologies. (Francis et al., 2009) In addition, standards include an expected level of quality. (Burns & Fogarty, 2010)

Traditionally, auditing standards have been developed over time to prescribe a desired set of auditor behavior to meet the objectives of an audit. Effective auditing standards take into consideration the complex environment that affects the auditor behavior and are designed to endorse the sound exercise of professional judgment. As noted by Baker et al. (2010), countries have tried to improve the quality of auditing by laws and regulations since the 19^{th} century. Rules have been created to preserve auditor independence, to demand increasing professional training and to improve codes of ethics. These rules along with the creation of public oversight boards have led to gradually improved audit quality.

Due to various national dynamics, audit and audit reporting practices are unanimous. As Burns and Fogarty (2010) suggest, auditor behavior is influenced not only by the used standards, but also by culture, inspections, enforcement, experience, education, firm methodologies and guidance. Church et al. (2008) found that the audit process is being influenced by factors that have typically been assumed irrelevant. The auditor can control some of these factors, although the controllable factors may have an effect on the reporting decision, unbeknown to the auditor. Based on their literature review, the following factors were pointed out:

1) The nature of accounting standards (principles-based vs. rules-based) affects the audit process through the effect of auditor-client negotiations.

2) Auditors focus strongly on negative evidence, which can affect the auditor's litigation risk as it affects the evaluation of evidence. Thus, the higher the litigation risk, the higher the probability of auditors to interpret evidence as indicative of failure.
3) The order of audit evidence may have an effect on the reporting decision. It was found that the evidence examined later (in a sequence) had a higher impact on the reporting decision than the prior evidence.
4) The evidence gathered by the auditor has a stronger impact than if the same evidence was gathered by another staff member.
5) Audit seniors bias the evidence in working papers to support their prior opinion. This biased documentation can work through the review process and thus influence the partner's judgment.
6) Knowledge of expectations may influence the auditors' going concern evaluations, i.e. if the subordinate auditors know a partner's beliefs of GC, they evaluate evidence accordingly and make GC judgments consistent to those of the partner.

This leads to the first hypothesis of the study.

H1: Audit reports vary internationally more so than nationally.

Nevertheless, the national auditing standards do agree on the fact that the auditors must render an opinion at the end of their audit process. There are certain agreed on elements of the audit reports that all auditors must be followed. They will be discussed in the following chapter.

2.4 The Role of Audit Reporting

The auditor's report communicates how well the management's assertions correspond with the financial reporting criteria. Thus it is important for the audit reports to develop simultaneously as the reporting standards are changed. Although the auditor's first-hand responsibility is towards the owners, the audit report is also of value to other stakeholders. (Eilifsen, 2010) The differences between audit procedures and the emphasis given to an audit then on their part affect what auditors are required to report based on the audit.

The auditors are required to render an opinion on the financial statements and other nationally determined elements. The audit report must be published together with the annual accounts and annual report. (Fourth Directive) If the auditors have no reservations to make, they must distribute an opinion on the annual statements that the requirements of the true and fair view have been met and that reasonable assurance has been received. According to King (1999), all Member States of the EU have some type of Company Law that describes the form and content of the annual report to which the auditor expresses an opinion. However, the manner in which professional standards is enforced will affect both the form and content of the audit report.

If the requirements have not been met or there is sufficient reason to believe so, the auditors must issue an opinion subject to reservations or withhold their opinion. (KPMG, p. 864) This is a way for auditors to promote good corporate reporting. The auditors may issue an audit qualification on the status of the client company as a going concern, or on the validity of the underlying accounting policies and their conformity with the prevailing accounting standards. (KPMG, p. 2704) Deviation from the standard audit report format is a powerful communication tool and acts as a warning signal to the stakeholders.

Based on the opinion, the audit reports can be categorized into four classes:

- unqualified/clean
- qualified
- adverse
- disclaimer

This study will focus on examining audit reports with unqualified opinions. The long form of the audit report, which has spread internationally, consists of three parts: the introduction, the scope and the opinion. In the unqualified audit reports, the introduction, scope and opinion are in standard format, i.e. they do not contain any qualifying comments or sentences. However, the report may also contain an explanatory paragraph or a modified wording part in which the auditor can point out a significant uncertainty, going concern issues or an acceptable deviation from the consistency principle in accounting without qualifying the audit opinion. (Troberg, 2007) In addition, countries may have additional requirements for the contents of the audit reports.

The current disharmony and possible contradictory nature of national auditing standards and rules creates an added level of complexity to the conduct of transnational audits and may prove to be simply unsustainable (Fraser, 2010). As companies are becoming more international nature, they bring more challenges to the auditors because of the national auditing regulations and institutions. The auditors or teams of auditors must take a more global view to be able to issue an opinion on a transactional corporation. Thus, there is a profound need for internationally agreed auditing standards. As Fraser (2010) notes, “the ability for the entire audit team – wherever they are located - to be able to follow the same standards facilitates communication within the team, helps ensure a uniform level of quality, and removes a source of confusion and hence potential non-compliance”. The following chapter will discuss the need and benefits that could be derived from harmonization.

Despite the fact that auditing is required through international and national legislation, there are quite distinctive differences in the audit reports between countries. In order to resolve where these differences stem from, one must look into the national dynamics that affect not only the audit reports but also the auditing processes behind them. The following chapter will discuss these dynamics, beginning with an analysis of cultural and legal issues, and then progressing further into comparing national audit institutions and audit legislation. One could expect that national differences stemming from culture and jurisdiction are visible in the manner in which they emphasize the importance of audit and its scope. These for their part then affect what the auditors are required to publish in their reports.

3 NATIONAL DYNAMICS

As the basis for audits and their reporting have been laid down, this chapter will look into different national dynamics, which could determine why the auditing processes and the reporting thereof vary between countries. The chapter will begin by introducing two cultural frameworks. Culture can be perceived as a determinant factor causing international differences in reporting traditions. Legal and control traditions are also of importance and they will be discussed in the following chapter, relying on the division between civil law and common law countries. According to Whittington (2008), the institutional framework for accounting includes the structure of markets, company law, tax law, regulation, and inherited practices of accounting and corporate governance. These national institutions will be discussed in chapter 3.3. The final section of this chapter draws conclusions on the national dynamics.

3.1 Cultural Frameworks

Whittington (2008) defines (accounting) culture as: “the institutional framework of accounting, including the market environment, in which it operates, and the specific practices and beliefs about the role of accounting that has grown up within that framework”. Dent (1991) defines culture as an ideational system and as such, it is produced and reproduced through action and interaction, implying that cultures are not programmed or static. There are several frameworks available that have been developed to depict the differences between cultures, many of which have their roots in anthropology. Some however, have been built on the need from international business. This chapter will introduce the five dimensions by Geert Hofstede (1982) and a further elaboration thereof by Gray (1988).

Geert Hofstede developed his model of five cultural dimensions in order to facilitate the interaction between people from different countries. He defines culture as “the collective programming of the mind which distinguishes the members of one human group from another” (1982). Thus, although culture is basically a mental program it becomes captured and reinforced in the institutions and tangible products of a society (Hofstede, 1984). This theory of culture is based on the notion that cultural and sociological differences between nations can be categorized and quantified to be able to compare national cultures. Initially, Hofstede determined four cultural dimensions but later on added a fifth. These dimensions he then used to value systems at various levels, such as in the state and in the mindset of people. He grouped them as follows:

1) Power Distance
2) Uncertainty Avoidance
3) Individualism / Collectivism
4) Masculinity / Femininity
5) Long-term / Short-term Orientation

Power distance describes the extent to which the less powerful members of the institution or organization accept the uneven distribution of power. According to Hofstede (1982), this distance can be either high or low and that the level of power distance at which the powerful and less powerful tendencies will find their equilibrium is societally determined. High power distance can be found in countries where inequalities develop over time into inequalities of power and wealth. In low power distance countries, people tend to see themselves more as equals. The ratio was relatively high in comparison to the other countries.

Uncertainty avoidance depicts the extent to which people feel intimidated by ambiguous situations and create beliefs and institutions to avoid them. Hofstede (1982) determines three indicators of uncertainty avoidance: rule orientation, employment stability and stress. Cultures with a high level of uncertainty avoidance try to diminish the possibility of unstructured situations by e.g. strict laws and rules as well as safety and security measures. Cultures with low uncertainty avoidance are more relaxed towards unstructured situations and attempt to minimize the amount of rules. Germany, France and Finland can be defined as having relatively high uncertainty avoidance, whereas United Kingdom has the lowest.

Individualism/Collectivism is the degree to which people are integrated into groups. In individualistic cultures people tend to look after themselves and their immediate family. People see themselves as independent and autonomous. By contrast, in collectivist cultures people belong to groups or collectives, or look after each other in exchange for loyalty. They have respect for tradition, thrive to fulfill social obligations as well as aspire to protect one's 'face'. All four countries are more or less on the individualistic side.

Masculinity/Femininity (or Achievement/ Nurturing) refers to the dominant values of a society. In masculine cultures success, money and possessions play an important role, whereas feminine cultures value sensitivity, caring for others and quality of life. Finland and France are less masculine than Germany and the United Kingdom. Long-term/Short-term orientation is based on Confucian dynamism. Cultures with long-term orientation appreciate values oriented towards the future, especially thrift and persistence. Cultures, which have a short-term orientation, have values, which are oriented towards the past and the present. (Hofstede, 1984)

According to Arnold et al. (2008), the constructs of Hofstede's five dimensions are important to international accounting, as they have been found to have a link to ethical dilemmas. This view suggests that standards may be interpreted differently, even among countries that are closely located to each other as in continental Europe. Further, culture plays an important role in the direction and outcome of audit results (Arnold et al., 2008). It has also been claimed that a country's accounting system may have developed as a result of culture (Collins & Bloom, 1997, in Arnold et al., 2008).

Elaborating on Hofstede's research, Gray (1988) notes that societal value orientations (given that such values permeate a nation's social system) and development of accounting systems are related at the sub-cultural level and thus there should be a close match between culture areas and patterns of accounting systems internationally. (Figure 1) Based on accounting literature practice, Gray (1988) was able to identify four accounting values or value dimensions at the level of the accounting subculture, which are related to Hofstede's (1982) identified societal values. However, Gray (1988) also comments that these four are an attempt to identify seemingly widely recognized value dimensions and therefore may not be the only values involved. Gray's (1988) four values are:

1) Professionalism vs. Statutory Control,
2) Uniformity vs. Flexibility,
3) Conservatism vs. Optimism, and
4) Secrecy vs. Transparency

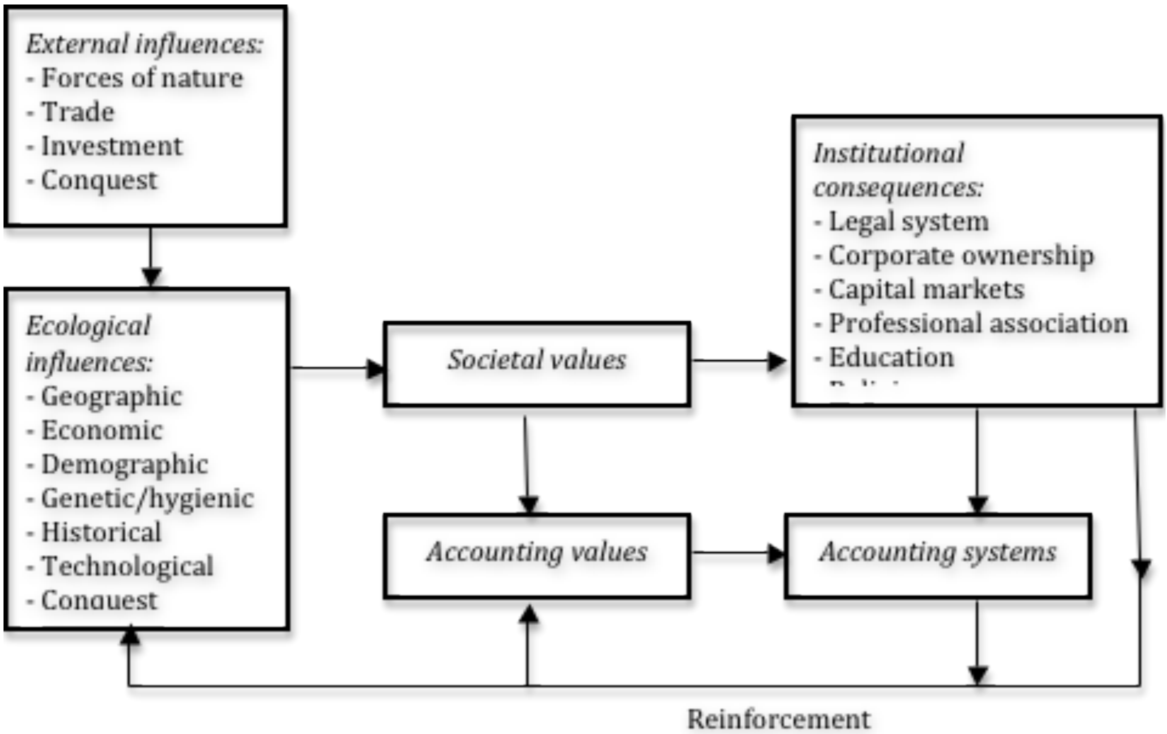

Figure 1: Culture, societal values and the accounting sub-culture (Gray, 1988)

Professionalism vs. statutory control refers to the preference between individual professional judgments and the maintenance of professional self-regulation and compliance with prescriptive legal requirements and statutory control i.e. should the accounting profession be publicly regulated/under statutory control or be permitted to retain control over accounting standards under private self-regulation. According to Gray (1988), it is perceived that accountants more or less adopt independent attitudes and exercise their individual professional judgments everywhere in the world.

As the accountancy profession has a long history in the Anglo-Saxon tradition (e.g. Troberg, 2007), it is firmly established in the UK. The presentation of 'true and fair view' of an entity's financial statements is highly dependent on the accountant's judgment as an independent professional. (Gray, 1988) On the contrary, the traditional position of the professional accountant's role in Finland, France and Germany has been mainly concerned with the implementation of relatively prescriptive and detailed legal requirements. (Gray, 1988) However, these traditional positions have changed along with the harmonization of accounting rules and regulations. Gray (1988) argues that high professionalism is most related with individualism and uncertainty-avoidance.

The next value, *uniformity vs. flexibility*, is open to different interpretations varying between a relatively strict inter-company and inter-temporal uniformity, and relative flexibility of accounting practices customized towards the circumstances of individual companies. It is also stated that attitudes towards uniformity, comparability or consistency are built into accounting principles worldwide. (Gray, 1988) Traditionally, in France, Germany and Finland a uniform accounting plan has been used, combined with the obligation of tax rules for measurement purposes and with a concern for facilitation of national planning and pursuance of macroeconomic goals. In the UK, however, there has been more concern with over time consistencies along with some degree of company-wide comparability subject to a perceived need for flexibility. Here again, Gray (1988) claims that uniformity can be related closest with uncertainty-avoidance and individualism.

Conservatism can be claimed as one of the most pervasive principles of accounting valuation and perceived as a fundamental attitude of accountants worldwide. Conservatism varies between countries, from the highly conservative approach of the Continental European countries to the less conservative accountant attitudes in the UK. It has also been noted that the conservatism of accounting measurement practices seem to be reinforced by the relative development of capital markets, differing pressures of user interest and the influence of tax laws on accountants. Uncertainty avoidance is said to be the closest societal value to conservatism. (Gray, 1988)

According to Gray (1988), *secrecy vs. transparency* on the quantity of information disclosed to outsiders derives as much from the management as from the accountant owing to the management. However, it is said that secrecy (or confidentiality) is a fundamental accounting attitude in business relationships. Like conservatism, secrecy is said to imply a cautious approach to financial reporting in general, although conservatism is related to the measurement dimension and secrecy to the disclosure dimension. The extent of confidentiality varies across countries, with lower levels of disclosure in Continental Europe than in the UK. The differential development of capital markets and the nature of share ownership seem to have had an impact on these differences as with the conservatism. Gray (1988) would link secrecy the closest with uncertainty-avoidance, power-distance and individualism.

3.2 Legal and Control Traditions

Laws differ markedly around the world, resulting in that no two nations' laws are exactly alike. However, legal scholars agree that some national legal systems are similar enough in certain critical respects to permit classification of national legal systems into two major families of law. (La Porta et al., 1998) Thus in most places laws tend to give investors a rather limited collection of rights. According to these scholars, commercial laws can be in general divided to two broad traditions: common law, which is English in origin, and civil law, which derives from Roman law. Within the civil tradition, there are three major families: French, German and Scandinavian. As a result of conquest, imperialism, borrowing and imitation, French and German civil traditions, as well as common law traditions, have spread around the world. (La Porta et al., 1998)

The civil legal tradition, also known as Romano-Germanic tradition is the oldest, most influential and most widely spread legal tradition around the world. As can be concluded from the name of the tradition, it originates from the Roman law. "The tradition uses statutes and comprehensive codes as a primary means of ordering legal material, and relies heavily on legal scholars to ascertain and formulate its rules." (La Porta et al., 1998) As mentioned in the introduction to this chapter, three common families of laws within the tradition are German, French and Scandinavian. The main agency issue in civil law countries is the too high concentration of ownership and, consequently, large shareholders may use their voting power to extract private benefits from small shareholders (López-de-Foronda et al, 2007). This too high concentration of ownership may result in costs, as core investors are not diversified. It may also result in difficulties in raising equity finance, as smaller investors may fear expropriation by managers and concentrated owners (La Porta et al, 1998; Liljeblom & Löflund, 2006).

La Porta et al. (1998) continue that the protection of investors determines their readiness and willingness to finance firms. López-de-Foronda et al. (2007) agree and state that the concentration of ownership is said to be a consequence of poor investor protection. Thus corporate finance may critically turn on these legal rules and their enforcement. The differences of legal protection may also help explain why firms are financed and owned so differently in different countries. Traditionally, French civil law countries have the weakest legal protection of investors, whereas common law countries in general have the strongest, leaving German and Scandinavian countries in the middle. (La Porta et al. (1998)

The control of French companies is three-fold: it is divided between the state, the company management and families. Ownership is dispersed only to a small extent and thus their system of corporate governance is closer related to the insider model. The state has a pronounced role in French companies and even listed companies are under state influence, as French financial institutions are state-owned and/or controlled and function as the main capital providers. (Francis et al., 2009; Solomon, 2010, p. 218) Thus, it is unclear whether there is a strong agency demand for differential audit quality in France (Francis et al., 2009). However, Nowicki (2009) notes that French corporate finance has presented a gradual shift away from the vast government ownership of major banks and industrial groups and towards private sector ownership during the past quarter century. Foreign institutional investors have replaced to a large degree the French state and cross-shareholding state owned firms as the dominant equity holders of French industry and finance.

German companies have a highly concentrated corporate ownership, being primarily owned by families and other companies. In addition, a complex web of holdings and pyramids of intercorporate holdings are the most common forms of corporate holdings. Bank influence and control are dominant when shareholdings are widely dispersed. Edwards and Nibler (2000) agree and add that because of the concentrated ownership most large German companies do not face a conflict of interest between a large number of dispersed owners and entrenched managers who control the firm without an ownership stake. Instead, the most likely corporate governance issue in the large German companies is a conflict of interest between the controlling owner and the minority owners (Edwards & Nibler, 2000).

The Finnish ownership structure resembles closely to those of France and Germany. The most common controlling owner type in Finnish companies is the family/founder. Other notable owner groups are banks and the state, although not as profound as in the previous countries. Traditionally, the state has been a large owner; however it has decreased its holding in the past years. There is also a tangible presence of foreign investors. The Finnish stock market is relatively small, meaning that there are less publicly traded companies in Finland. (Liljeblom & Löflund, 2006) Finnish companies in overall are smaller than those of the other countries.

The government has had an extensive influence on financial reporting through taxation. This has been of great importance in Continental Europe and Finland, where the objective of financial reporting has been to minimize taxes rather than to give a true and fair view of the company's position and results. Troberg (2007) claims that a connection between taxation and financial reporting can be typically found in countries, which do not have an explicit investor approach in their financial reporting orientation, such as in our three case countries. The link is however weaker in United Kingdom.

The common-law family includes the law of England and those laws modeled based on it. Judges who have to resolve specific disputes form the common law. Precedents from juridical decisions shape common law. As a result of British colonialism, common law has spread to countries such as United States, Canada and Australia. (La Porta et al. (1998) According to López-de-Foronda et al. (2007), the main agency problem arises from the dispersion of corporate ownership and from a certain lack of shareholder activism. However, these countries offer the best legal protection to shareholders (La Porta et al, 1998).

The British companies rely more on equity capital and thus audits are used there as a corporate governance mechanism. (Ashbaugh & Warfield, 2003). In the UK, audits serve to reduce the risk of asymmetric information by adding to the reliability of a company's financial information and thus allowing current and prospective equity shareholders (investors) to evaluate a company's profitability and develop expectations for the distribution of its profits. Empirical studies have showed that the demand for audits as a corporate governance method is a method of audit quality and the insurance provided by the audit firm (Ashbaugh & Warfield, 2003).

Thus, the demand may be limited because of two reasons. Firstly, private debt holders have a more direct oversight of management as a major capital provider than dispersed and/or minority shareholders. Ashbaugh and Warfield (2003) suggest that the demand for audits may result merely as a consequence of statutory reporting requirements, as auditing is legally required. Further, they found that German laws limit audit firm liabilities, which suggests that auditing does not play an insurance role in the country. Secondly, a highly concentrated ownership usually means that the concentrated owners serve to monitor the management. However, the German reporting framework results in financial information less useful for equity investors. This, according to Ashbaugh and Warfield (2003), implies greater information asymmetries between managers and dispersed shareholders, which could result in a higher demand for external audits as a monitoring mechanism. The findings of Asbaugh and Warfield (2003) can be applied to Finland and France as well, due to similar capital markets.

On the other hand, as mentioned, the United Kingdom has an “outsider system” of corporate control, as they have large equity markets, dispersed ownership, and active markets in corporate control. According to Ashbaugh and Warfield (2003), previous research in the U.S audit market has showed that audits serve to monitor management and therefore contribute to companies’ overall corporate governance and thus protecting shareholders’ interests. Thus, it can be assumed that the same applies to the UK due to similarities in the capital market structure. A majority of Continental European capital markets, into which the other three countries can be counted among, however, have a small number of quoted companies, share ownership and comparatively lower levels of takeover activity and thus have more of an “insider system” of corporate control. (Franks & Mayer, 2001) As the countries have a less developed equity and debt markets and rely more on debt than equity capital, which result in a limited demand for auditing as a monitoring mechanism.

Further categorizing, King (1999) divides EU Member States into three categories based on the responsibility of standards promulgation: 1) the public sector has the primary responsibility for standards promulgation with the accounting profession serving in an advisory capacity, 2) the private sector has the primary responsibility for standards promulgation with the government acting in an oversight capacity, and 3) both public and private sectors share responsibility for standards promulgation. In the first category, accounting and auditing standards derive from the legislation enacted by the Company Law. In general, accounting standards are closely aligned with tax legislation. The main purpose of the audit for these countries is to determine compliance with the applicable law as well as adherence to the ‘true and fair view’ concept. Law dictates the contents of the audit report, the opinion therefore focusing on the compliance and true and fair view requirements. From the four countries examined, King (1999) includes Germany into this category.

In the second category, where Finland, France and the UK fall, professional accounting bodies promulgate the accounting and auditing standards within guidelines set by government legislation. Unlike in the first category, accounting standards differ from tax legislation.

Compliance with applicable law and the true and fair view requirements are perceived important. The audit reports usually have however a wider focus including adherence to generally accepted accounting principles, duties and responsibilities of directors, and disclosure of additional information to shareholders. The final category presents a mixture of professional and governmental involvement in the promulgation of standards.

Moreover, legal factors have played an important role in the historical development of accounting and auditing standards (Gorelik, 1994 in Arnold et al., 2008). Therefore, it can be seen that contingent fees and class-action suits have affected the litigious environment, the result of which is the level of specificity required disclosure in the accounting and auditing standards. Further, countries are said to have their own specific propensity toward litigation and this may have an effect on the auditor's application of auditing principles. Many believe that the threat of litigation influences the level of effort on audits. (Arnold et al., 2008)

Prior literature documents that the audits applicable in U.S firms provides information benefits to investors by contributing to the quality of firms' financial reporting and by disclosing going-concern uncertainties. In contrast, however, these kinds of results have not been achieved for other countries, as prior research has been inconclusive whether audits provide investors information. However, Gassen and Skaife (2009) note that the majority of the prior research on the information role of audits has focused on the common-law countries, where the information asymmetry between managers and owners forms a relatively homogenous demand for audit services. The study of Gassen and Skaife (2009) focused on Germany, where "the demand for audit services is more heterogeneous because of the cross-sectional variation in firms' ownership concentration and capital structure. Based on their findings, they suggest that by simultaneously requiring more focused audit objectives, more refined audit reports, stricter hiring practices, and increased legal liabilities, audit reforms (such as the one in Germany in 1998) can increase the information benefits of audits in countries where audits have mainly served a statutory reporting function.

All in all, based on these dimensions, it can be assumed that the institutions and regulations of Finland, France and Germany resemble each other. Their practices, structure and standards probably differ from those of the United Kingdom and therefore:

H2: The audit reports of Finnish, French and German companies have similar features but differ from those of the British companies.

3.3 Auditing Institutions

The regulatory requirements of auditing focus on protecting the public interest by enhancing the credibility and reliability of financial information of especially publicly traded companies. However, the manner in which this public interest purpose has been practiced varies from one country to another. (Baker et al., 2001; Baker et al., 2010) For example, it is defined principally in terms of well-functioning capital markets in the UK, whereas in Germany the statutory auditor is viewed to assist the supervisory board with respect to the proper functioning of corporate governance. Further, in Finland, France and Germany, the auditor is required to act on behalf of the state under certain circumstances. According to Baker et al. (2001), these differences of the definition of protecting the public interest derive from historical, political and economic differences between the countries examined.

Country-specific auditing institutions refer to the laws, regulations and standards for audits and auditors in each of the four countries. There are notable differences regarding the education of the auditors, the responsibilities of the auditor, the additional services they are allowed to provide, auditor liability and rules on independence. The national regulations will be discussed in more depth in the appendices. (Baker et al., 2001; 2010) Differences still exist, despite harmonization initiatives and directives on a European and international level (Maijoor et al, 2000). These initiatives will be discussed in chapter 4. In addition, national auditing institutions are said to reflect the economic function of financial information, which also can be expected to have an effect on the audit in the respective countries. The economic functions vary between countries, mainly as a result of variations in the structure of capital markets. In the UK, stock and bondholders of listed companies are important users of audited financial statements. In the other countries of the sample, financial information has a different function, as its main users are the state, banks and tax authorities. (Baker et al., 2001)

All four countries in the sample have their own institutions responsible for the national auditing regulations and practice. This chapter will introduce the main national institutions and the main auditing bodies. As mentioned above, German and British systems are often categorized as opposite ends of the accounting and regulatory environments. However, Vieten (1995) claims that this belief can be contradicted with an acknowledgment of the increasing state involvement in Britain and the recognition that the German system is not sufficiently characterized by rigid and exhaustive codification be rather relies on to a significant degree on professional expertise. The other two countries are often perceived as being in-between these contradicting ends. The description of audit institutions and regulations will begin from Finland, followed by French, German and British institutions.

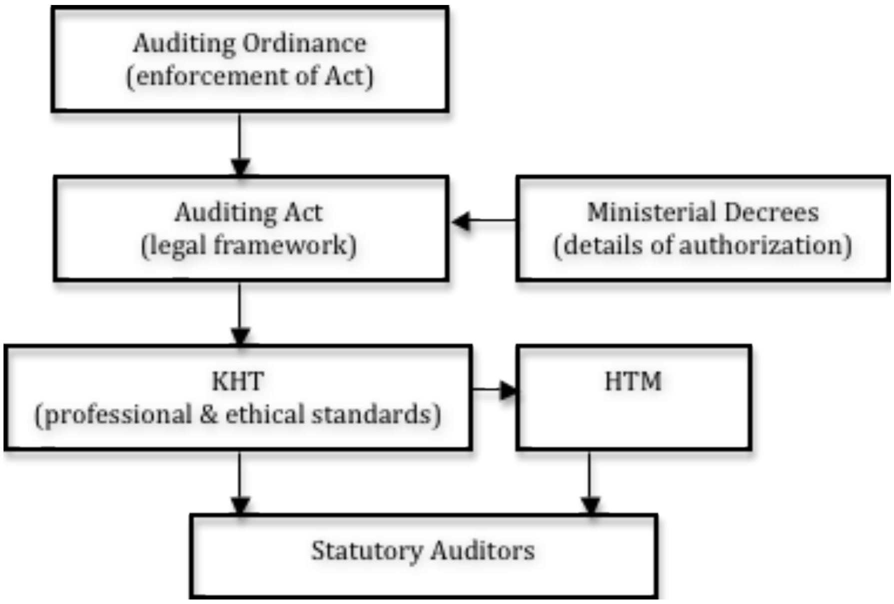

Figure 2: Regulations of statutory auditors in Finland.

The legal framework for auditing and auditors in Finland is laid out in the Auditing Act, Auditing Ordinance, and the Ministerial Decrees. (Figure 2) Detailed provisions on the enforcement of the Auditing Act are laid out in the Auditing Ordinance, which came into force simultaneously with the Act. The Act contains provisions for the statutory audit, the qualification requirements for auditors, authorization, and supervision of auditors. According to the Act, all registered companies, foundations and other legal entities must appoint an auditor to audit their annual and consolidated statements. Further, as laid down in the Auditing and Companies Acts, companies (subject to small company exemptions) must comply with the KHT audit rules. The Ordinance contains more detailed regulated procedures in oversight bodies. The Ministerial Decrees consist of detailed requirements of authorization. The Chamber of Commerce Act contains the basic guidelines of organizations and objectives of the Chamber of Commerce.

Finland has a two-tier system of auditors similar to that of Germany. (Figure XX) The Finnish Institute of Authorized Public Accountants (KHT) is a private, professional body responsible for setting national auditing standards and ethical requirements based on the International Federation of Accountants' (IFAC) recommendations and standards. It issues generally accepted auditing standards, which are based on ISAs, but with modifications reflecting the local legal environment. However, despite being conceived as standards for good auditing practice, they are not legally binding as are the standards given by its German counterpart.

The purpose of the Finnish audit is to enable the auditor to give a statement on whether the financial statements and the annual report give a true and fair view of the entity's results of operations and financial position in compliance with the applied accounting standards as well as whether the information in the financial statement and annual report are in compliance. As mentioned, the auditor must also audit the administration of an entity. The purpose of this audit is to determine the legality of the operations of the people accountable according to the legislation of the community.

The auditor must follow good auditing practice and special instructions from the partners, shareholders' meeting or equivalent governing body as long as they are not conflicting with the law, the articles of association, or good auditing practice. The Auditing Act 2007 adds that the instructions must not be contradicting with international auditing standards or professional ethics. The Act of 2007 requires additionally that an auditor must follow the engagements set out in the Act professionally, honestly, objectively and considering the common benefit. The auditor is also obligated to maintain and develop his/her professional skills. The KHT institution gives further ethical instructions to auditors. These instructions contain 5 elements; honesty, objectivity, professional competence and diligence, confidentiality and professional conduct. The development and main features of Finnish auditing regulations can be found in Appendix 1. The following section will discuss the national institutions of the French auditors.

The French auditors fall under the supervision of the Ministry of Justice (see Figure 3). In order to achieve the title of commissaire aux compte, an individual or firm must become a member of the Regional Institute of Statutory Auditors (Compagnie Régionale des Commissaires aux Comptes, CRCC) in the locality in which they are domiciled. They must be registered on the official list to be able carry out the functions and duties of the statutory auditor. The National Institute of Statutory Auditors (Compagnie Nationale des Commissaires aux Comptes, CNCC) plays a national coordinating role in the country's auditor regulation. All statutory auditors must be enrolled in the official lists of the CNCC. (Baker et al., 2010) The legal basis for audit regulation is found in the 1966 Company Law. The audit regulation and institutions are discussed in more detail in Appendix 2.

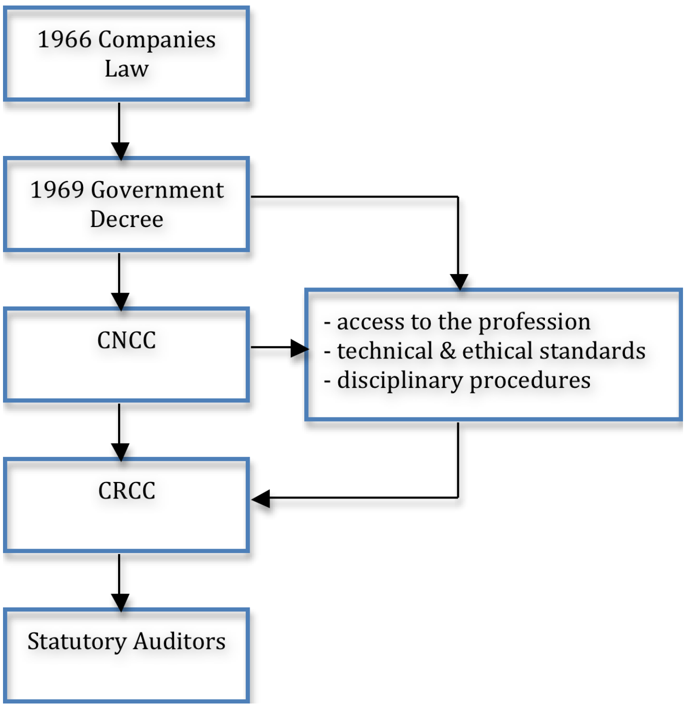

Figure 3: Regulations of statutory auditors in France (Baker et al., 2001)

Like the Finnish KHT, the National Organization of Registered Auditors (CNCC) is responsible for adopting auditing standards and preparing professional standards as well as disciplinary procedures. In addition, they formulate and issue ethical standards, issue technical standards and recommendations and oversee the peer reviews to ensure compliance with these standards. However, to be enforceable, these standards need to be endorsed by the Minister of Justice after a consultation with the High Council in France of Statutory Auditors (Haut Conseil du Commissariat aux Comptes, HCCC). The role of the CNCC has been increased in recent years to be able to encompass audits in many types of organizations. In addition to rendering an opinion on the true and fair view of the financial statements and financial position, the French auditor may also be called upon to intervene when companies seek additional capital or to initiate an early warning procedure for companies likely to encounter financial difficulties. (Baker et al., 2010)

The legally defined role of the French statutory auditor is often seen as an adjunct of the state in the general regulation of corporate activity. According to the Company Law, auditors must be selected from of a list of members of a CRCC and are appointed for a term of six years. The auditor cannot be dismissed during this tenure except under exceptional circumstances that require a court decision. The resignation is also restricted during the time. According to Baker et al. (2001), this may result in auditors feeling more secure in their position and thus not being as concerned about competitive pressures as auditors in the other countries with shorter appointments. The auditor can be reappointed without limitations for further six-year periods, although a mandatory audit partner rotation was introduced in the 2003 Financial Security Law (Francis et al., 2009).

The French auditing regulation is unique in the sense that all publicly listed companies preparing consolidated financial statements are required to be jointly audited by two independent auditors, with the audit effort shared and a single audit report issued by the two auditors of record. The requirement is based on the assumption that two auditors combine their competencies when facing problematic accounting issues and are able to collectively resist pressure from managing directors. (Baker et al., 2010) This requirement was further enhanced by the French Financial Security Law in 2003 as it formally requires that each auditor must independently cross-review the other auditor's work on the joint engagement. (Francis et al, 2009). As in other countries, each auditor must have a deputy who replaces the auditor should he/she be unable to perform their duties. The French law also forbids auditors from performing any salaried employment other than employment with an auditing firm and any commercial activity. The next section will discuss the institutions and regulations of Germany.

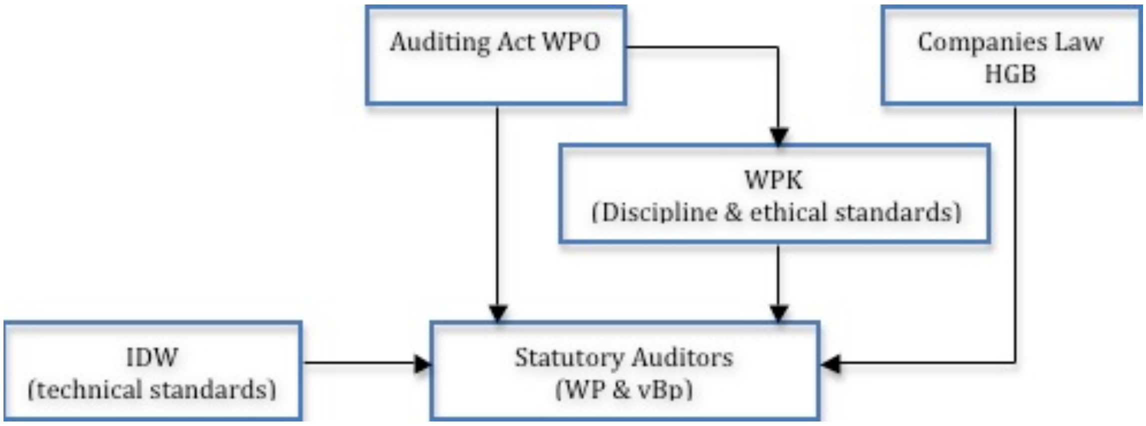

Figure 4: Regulation of the statutory auditor in Germany (Baker et al., 2001)

A dual system combining features of state and self-regulation operates in Germany as they has two main professional bodies, the Wirtschaftspruferkammer (The chamber of auditors, WPK), a public body under public supervision and the Institut der Wirtschaftsprufer (IDW), a private body setting auditing requirements with voluntary membership. (Figure 4) The WPK takes the form of a self-governing body, but is under the supervision of the Federal Minister of Economics of the German government, whose approval is required for changes to its constitution. Further, the membership of the WPK is mandatory and its directives are legally binding for practicing auditors.

The main objective of the WPK is to regulate auditors in accordance with the provisions set in the WPO. The main responsibilities of this chamber are professional ethics, supervision and disciplinary procedures, representation of the profession to other parties and the organization of professional examinations. The regulations of the WPK are legally binding, as opposed to those of the British APB. The IDW, on the other hand is the member's trade organization. Its membership is voluntary but confined to the practicing auditors only. The IDW publishes auditing guidelines, which are considered good audit practice yet not being compulsory and comments on training issues. Both the IDW and WPK are listed as members of the IFAC. (eStandardsForum, 24.10.2010)

As in Finland, there are two professional qualifications in auditing. These are the Wirtschaftsprüfer (WP) and the vereidigter Buchprüfer (vBp). Like the HTM auditors in Finland, the vBp is a lower qualification as they are allowed to audit only medium sized, private limited liability companies (GmbH). Auditors can either be qualified natural persons or audit corporations as long as they are members of the WPK. The WPK members include also a third type: the unqualified members of the boards of management, managers and partners of audit firms. (Francis et al., 2001)

The audit objective is to identify noncompliant financial reporting practices and to form an opinion on the company as a going concern. The auditor is required by law to modify the audit report and publicly disclose a going-concern limitation, a disclosure omission or a violation of GAAP. The German statutory audit culminates in the issuance of two documents. First, a public audit report is issued to accompany the published financial statements. This is the type of audit report as published in other countries as well. The second document is a confidential audit report called the long-form audit report. The role of the statutory auditor in Germany is different from that of the British auditor, but similar to the French auditor. The basic function of the auditor in Germany is to assist the supervisory board and hence the audit report is usually addressed to the board.

According to Ashbaugh and Warfield (2003), the audit process typically provides compliance assessments and thus serves a statutory role in Germany. They also suggest that audits play a corporate governance role when companies have stakeholders that demand reliable financial information. The purpose of commercial accounting and financial reporting, both law enforced, is to serve people. The most important and most protected groups of people are the creditors and the owners. It is also in the national interest, as accounting and tax accounting are interrelated. (eStandardsForum, 23.10.2010) The next section will discuss the institutions and regulations of the British auditors.

The British 1989 Act included provisions that 'ensure that only persons who are properly supervised and appropriately qualified are appointed as company auditors, and that audits are carried out properly, with integrity and with a proper degree of independence' (Sherer & Turley, 1997 in Baker et al., 2001). In order to achieve this goal, certain long-established professional accountancy bodies were established as Recognized Supervising Bodies and Recognized Qualifying Bodies for statutory auditors. The auditing profession in the UK includes also bodies with no connection to auditing. The UK government's Department of Trade and Industry has recognized the following bodies to supervise their members for audit work: ACCA, ICAEW, ICAI, ICAS and AAPA (Association of Authorized Public Accountants). The structure of the British auditing regulation is depicted in Figure 5.

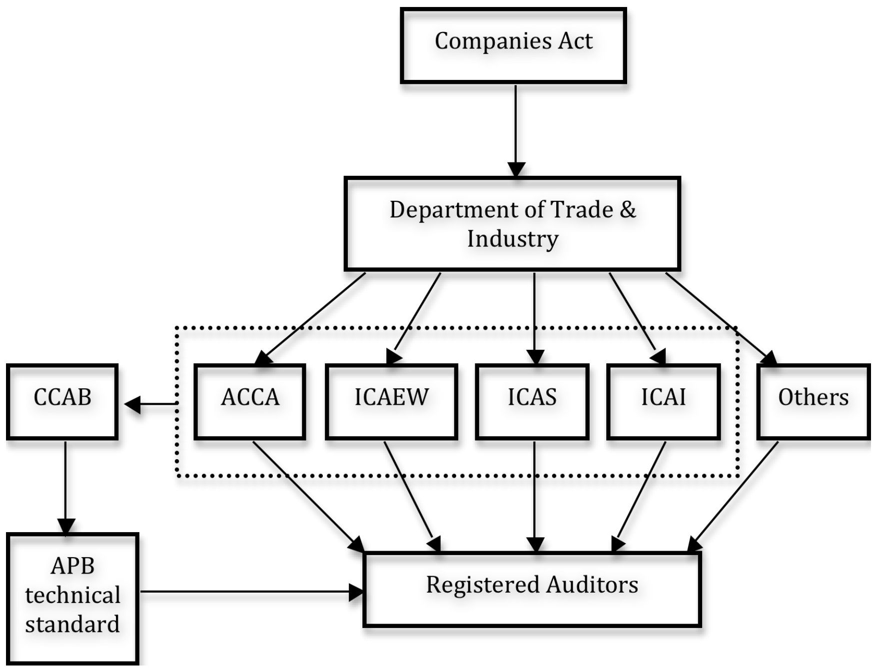

Figure 5: Regulation of statutory auditors in the UK (Baker et al., 2001)

ACCA = Association of Chartered Certified Accountants

CCAB = Consultative Committee of Accountancy Bodies

ICAEW = Institute of Chartered Accountants in England and Wales

ICAI = Institute of Chartered Accountants in Ireland

ICAS = Institute of Chartered Accountants in Scotland

The main purpose of the Auditing Practices Board (APB) is to lead the development of auditing practice in the UK and the Republic of Ireland. Its main objectives are to 1) establish high standards of auditing, 3) meet the developing needs of users of financial information, and 3) ensure public confidence in the auditing process. In order to fulfill these objectives, the APB issues Statements of Auditing Standards (SASs), Practices Notes and Bulletins. The practice notes aim to offer guidance to auditors in the application of auditing standards. Bulletins, on the other hand, provide guidance in emerging issues. Both are perceived as part of good practice although not mandatory. The regulation of auditors has proceeded through recognized professional bodies in the UK, whereas in the other countries, it has developed through legally established quasi-governmental bodies. (Baker et al., 2001)

When it comes to regulation, UK has traditionally adopted a somewhat laissez-faire approach, leaving the auditing profession to regulate itself. However, the state-involvement has steadily increased due to two strategies: legislative change and restructuring the standard-setting process. Thus, the UK is moving closer to the German system. (Vieten, 1995) The auditor is required to report to the shareholders whether the financial statements give a true and fair view of the financial position and results of operations and whether the financial statements have been properly prepared according to the Companies Act. As in other countries, the British auditors must be appointed in an annual general meeting by the shareholders. Unlike in France, the British auditors are appointed for one year at a time and must be reappointed on an annual basis by the shareholders. However, certain concerns related to issues of independence, objectivity and integrity have been raised because of this arrangement (Baker et al., 2001). In addition, the Acts contain provisions related to the removal and resignation of auditors, the manner of setting the auditor's remuneration and the auditor's rights to have access to information and explanations from managing directors and to communicate with shareholders.

The main differences between the national auditing institutions are depicted in Table 1

	Finland	France	Germany	United Kingdom
Legal system	Civil law	Civil law	Civil law	Common law
Ownership concentration	Moderate	Moderate/high	Moderate/high	Low/moderate
Main owners	Family/founder, state & banks	State, management, family	Family & other companies	Shareholders
Corporate control	Insider	Insider	Insider	Outsider
Concept of firm	Institutional	Institutional	Institutional	Instrumental, shareholder-oriented
Importance of stock market in the national economy	Moderate	Moderate	Moderate/high	High
Standards promulgation	Private sector has primary responsibility, government acts as oversight	Private sector has primary responsibility, government acts as oversight	Public sectory has primary responsibility, accounting profession serves as advisory capacity	Private sector has primary responsibility, government acts as oversight
Position of auditing profession	Traditional; concerned with implementation of prescriptive & detailed legal requirements	Traditional; concerned with implementation of prescriptive & detailed legal requirements	Traditional; concerned with implementation of prescriptive & detailed legal requirements	Highly dependent of accountant's judgment as an independent professional
Auditing body	KHT & HTM	CNCC & CRCC	WPK & IDW	APB
Supervision by	Central Chamber of Commerce	Ministry of Justice	Auditing Oversight Board (OAB)	Department of Trade & Industry
Legal framework	Auditing Act, Auditing Ordinance & Ministerial Decrees	Companies Law & Government Decree	German Commercial Code (HGB)	Companies Act
Standard-setting	KHT sets national auditing standards & ethical requirements based on ISAs	CNCC sets ethical & technical standards, recommendations	Both WPK & IDW set standards	APB issues statements of auditing standards, practice notes and bulletins
Validity of standards	Perceived as part of good auditing practice, which auditors are required to follow	Must be enforced by Ministry of Justice to be legally binding	Standards of IDW perceived as good auditing practice but not legally binding; WPK's standards legally binding	Perceived as good auditing practice, but not legally binding
Scope of audit	Bookkeeping, financial statements, annual report & administration of an entity	Financial statements, justification of assessments,	Financial statements & the management report	Financial statements, Director's report, corporate governance

Table 1: Comparison of national institutions, adapted from Weimer & Pape, 1999.

3.4 Need for Harmonization

Maijoor et al. (2000), suggest that auditing is claimed to have become an increasingly global discipline. Differences between national auditing practices seem to have decreased as a result of the expansion of the international audit firm networks and the proliferation of International Standards on Auditing (ISAs). However, the existence of strong national auditing institutions hinders this development. They cause problems with generalization as well as restrain the development of a uniform European audit (research) market. Therefore, there is high demand for harmonized practices and regulation. In addition, Arnold et al. (2008) remark that even though auditing standards were similar or harmonized their application could vary across countries due to cultural issues.

Fraser (2010) presents several benefits to global reporting framework, consisting of high quality accounting and auditing standards:

- Greater comparability of financial information for investors,
- Greater willingness on the part of investors to invest across borders,
- Lower cost of capital,
- More efficient allocation of recourses, and
- Higher economic growth.
-

Van der Tas (1988) agrees and suggests that there are three goals in financial reporting harmonization. Firstly, the financial reports should be harmonized to an extent which providers and users are able to understand and analyze and that the standards should be equivalent in trade-sensitive issues. Secondly, harmonization would enable the abolition of obstacles of free movement of people, services and capital between member states. Thirdly, it would institutionalize creating a system that would ensure undistorted competition in the internal market and the approximation of laws of member states to the extent required for the proper functioning of the internal market.

As the audit report is the primary communication tool of auditors, its harmonization is of high importance. “The auditor’s report is almost the only formal means used to both educate and inform users of financial statements concerning the audit function” (AICPA, 1978 in Gangolly et al., 2002). Gangolly et al. (2002) note that while the harmonization of the audit report is important in its own right, it can also add to the improvement of accounting and auditing standards. Therefore, they offer three arguments why the harmonization of audit reports is important in an international setting:

1) Information asymmetry
2) Information search, and
3) Standard-setting costs

As financial statements may vary as a result of different legal, regulatory and business environments, financial statement users may be more familiar with reports issued by domestic entities than by foreign ones. This can lead to information asymmetries between the users of the financial statements. However, these could be reduced with harmonization as it can lead to more efficient and effective allocation of resources in international capital markets. Secondly, information asymmetry can incur search costs, as foreign investors try to investigate investment opportunities and preparers have to impose costs to meet the credibility thresholds of capital suppliers from many countries. These costs could be reduced with standardized financial statements. Also setting the standards can be costly. In addition to development costs, there are additional costs that incur from having to communicate and educate the rest of the world on the reasonableness of such national standards in an international setting. These costs could set an excessive burden on both the suppliers and consumers of capital in the international market. (Gangolly et al., 2002)

Further complicating matters, there has been a lot of discussion of the expectations gap, which is used to describe similar issues as Gangolly et al. (2002) presented above. According to this view, users of audited financial statements misunderstand both the role of the auditor in the financial reporting process as well as the meaning of the audit report itself. (King, 1999) Church et al. (2008) extend the definition further and note that users do not fully understand the role and responsibilities of the auditor. The societal concern for the work of auditors has been increased by the use of creative accounting and following business failures.

The expectations gap can be divided into two types of gaps (Figure 6). Firstly, a performance gap refers to either 1) the gap between what the auditing profession expects auditors to deliver and what auditors are really delivering (performance shortfall), or 2) the gap between what the auditor is delivering and what the public thinks they are delivering (audit performance deficiency). Secondly, the standards gap is used to describe the difference between the perception differences between the public and the auditing profession of what the auditor should be doing. (KPMG, p. 2707)

In addition, there is confusion regarding the content and meaning of the report, the audit process and the level of assurance provided. As such, there is a concern of the communicative value of the auditor's report, although the audit report is said to be the primary communication tool of auditors (e.g. Eilifsen, 2010). Further, Church et al. (2008) state that in fact the report has merely symbolic value as it conveys only little information.

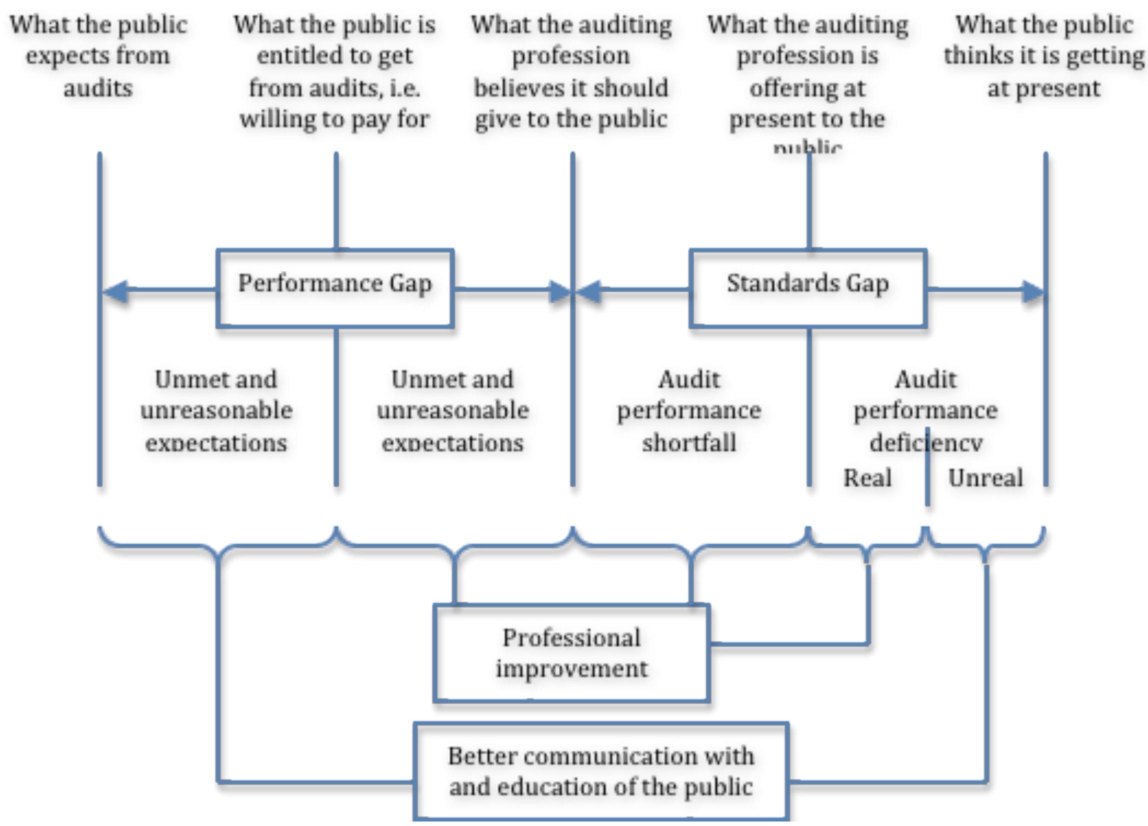

Figure 6: Expectations gap, adapted from (KPMG, p. 2707)

The expectations gap is further complicated, as member states of the EU do not share a common language, a common economic, social and political systems nor a common set of generally accepted auditing standards (King, 1999). In order to decrease the expectations gap, one of the recommendations of the Cadbury Committee (1992) is that directors of reporting companies should indicate the extent of their responsibilities for the financial statements and their underlying accounting records. This leads to the second hypothesis of the study.

H4: The audit reports have increasingly detailed descriptions of responsibilities and the audit process itself.

As a common practice, international companies with multi-national operations usually appoint one of the Big 4 accounting firms to conduct their audit. There are several benefits deriving from the use of these firms. They are able to offer the depth of their professional and a large degree of 'local' presence through their multiple offices worldwide. As pointed out by Arnold et al. (2008), the Big 4 typically announce a concept of 'one-firm-world-wide'. They also present that while the audit systems, procedures and professional staff training can be designed and applied consistently throughout the worldwide offices of a Big 4 company, the companies have to however primarily employ individuals from the local country. This may lead to inconsistencies in the firms' policies as it has been researched that country-culture plays an important role in the manner in which a person functions and approaches problems (Arnold et al., 2008).

However, there have been some concerns related to the audit profession as audit firms compete with each other for business. As a business, they wish to maximize their business with companies. Nevertheless, this may not be a bad thing as the companies compete on the basis of their professional reputation and therefore function as an incentive to maintain high standards. The profession's ethical guidance and threat of litigation may also encourage this goal. On the downside, audit firms compete on price and on meeting the clients' needs possibly at the expense of meeting the need of the shareholders. (Cadbury, 1992)

4 INTERNATIONAL HARMONIZATION

In order to create effective capital markets, essentially within the EU, it is crucial to make sure that investors have access to comprehensible, comparable and reliable information. (Troberg 2007, 18) According to Combarros (2000), there is a unanimous agreement on the need for an international accounting process. As Barley and Haddad (2007) state, “The main objective of international accounting harmonization is to reduce international differences in accounting principles and to enhance comparability of accounting information”. Further, reliable reporting standards need high quality auditing standards aside. The issue lays in the fact that business and capital markets have gone global, but relevant laws, regulations and standards remain predominantly national in nature, which may even conflict with one another. (Fraser, 2010) This chapter will begin with a definition of harmonization and then main attempts towards the harmonization and development of the audit report.

The initial need for international harmonization was realized as an increasing number of large European companies, the so-called global players, had begun to seek capital on the international capital markets and were thus were forced to prepare two sets of financial statements, one in according to the capital market requirements, i.e. IAS or US GAAP and the other prepared according to the national law based upon the Accounting Directives. In 1995, the European Commission suggested a new approach to accounting harmonization with the EU in its communication ‘Accounting Harmonization: A new strategy vis-à-vis international harmonization’ COM 95 (508). According to the approach, the Union’s weight should be put behind the international harmonization process, which at the time was ‘well under way in the International Accounting Standards Committee (IASC)’. Already then, the objective was to establish a set of standards, which would be accepted in capital markets world-wide.

4.1 Definition of Harmonization

“Harmonization is a coordination, a tuning of two or more objects” (Van der Tas, 1988). Tay and Parker (1990) present that both terms ‘harmonization’ and ‘standardization’ have been used rather loosely in the accounting literature. They define the terms using the states of harmony and uniformity:

"Harmonization (a process) is a movement away from total diversity of practice. Harmony (a state) is therefore indicated by a 'clustering' of companies around one or a few of the available methods. Standardization (a process) is a movement towards uniformity (a state). It includes the clustering associated with harmony, and reduction in the number of available methods."

According to Tay & Parker (1990), these four terms exist at the levels of principles, concepts, regulations and practice. Further, states and processes can be either de jure (harmony or uniformity of accounting regulations) or de facto (actual practices of companies). They also comment that the use of these four terms is also necessarily linked with the type of data used, meaning that the study should be either de jure or de facto by nature. Further categorizing, harmony and uniformity are states, but (dis)harmonization a process, which reflects a decrease / an increase in the level of harmony (Tay & Parker, 1990; van der Tas, 1992).

Van der Tas (1988) calls the harmonization of financial reports *material* (same as de jure in Tay & Parker, 1990) harmonization and the harmonization of standards *formal* (de facto) harmonization. Mustata & Napoca (2010) add that material harmonization is aimed at the disclosure of particular information with a particular degree of detail, which is perceived as the minimum requirement for all financial reports. To avoid confusion in the text, the terms formal and material will be used in the paper. The types of harmonization coexist, as formal harmonization can be a means of achieving material harmonization through coordination of national standards as well as being an end result itself. However, if the coordination of standards leads to more options for companies in a country, disharmony may accompany formal harmonization. There has been quite a lot of discussion on the measurement of harmonization (van der Tas 1988; 1992; Tay & Parker, 1990; Mustata & Napoca, 2010). The basic conclusion is that harmonization can be measured, but there has not been an agreement on an exhaustive study method. In addition, e.g. Mustata and Napoca (2010) and Fontes (2005) present that it is not possible to develop one method to measure both material and formal harmonization. Thus, differing methods should be developed for measurement and disclosure issues respectively.

Van der Tas (1988) presents also a third type of harmonization, *spontaneous* harmonization, which he describes as material harmonization taking place without being initiated by standard setting. Mustata & Napoca (2010) further elaborate on the findings of van der Tas (1988) and conclude that spontaneous accounting harmonization can be perceived as an alternative for the natural evolution of the accounting harmonization process. In addition, they state spontaneous harmonization can be conceived as a consequence of market influences rather than as an effect accounting regulations and their harmonization. Here, standards have been defined as any financial reporting rule published by a private standard setting body or the government. Standards lead towards harmonization as they limit the company's choice between alternatives. Further, they can refer to either the degree of disclosure or to the accounting method to be applied. The harmonization related to the former is called *disclosure* harmonization and the latter *measurement* harmonization. Based on disclosure and measurement, van der Tas (1988; 1992) classifies four domains of harmonization, which are depicted in Figure 7:

- Material measurement harmonization (harmonization of measurement methods)
- Material disclosure harmonization (harmonization of the amount and detail of data disclosed in financial reports)
- Formal measurement harmonization (harmonization of measurement methods required by national standards)
- Formal disclosure harmonization (harmonization of the amount and detail of data disclosure required by national standards)

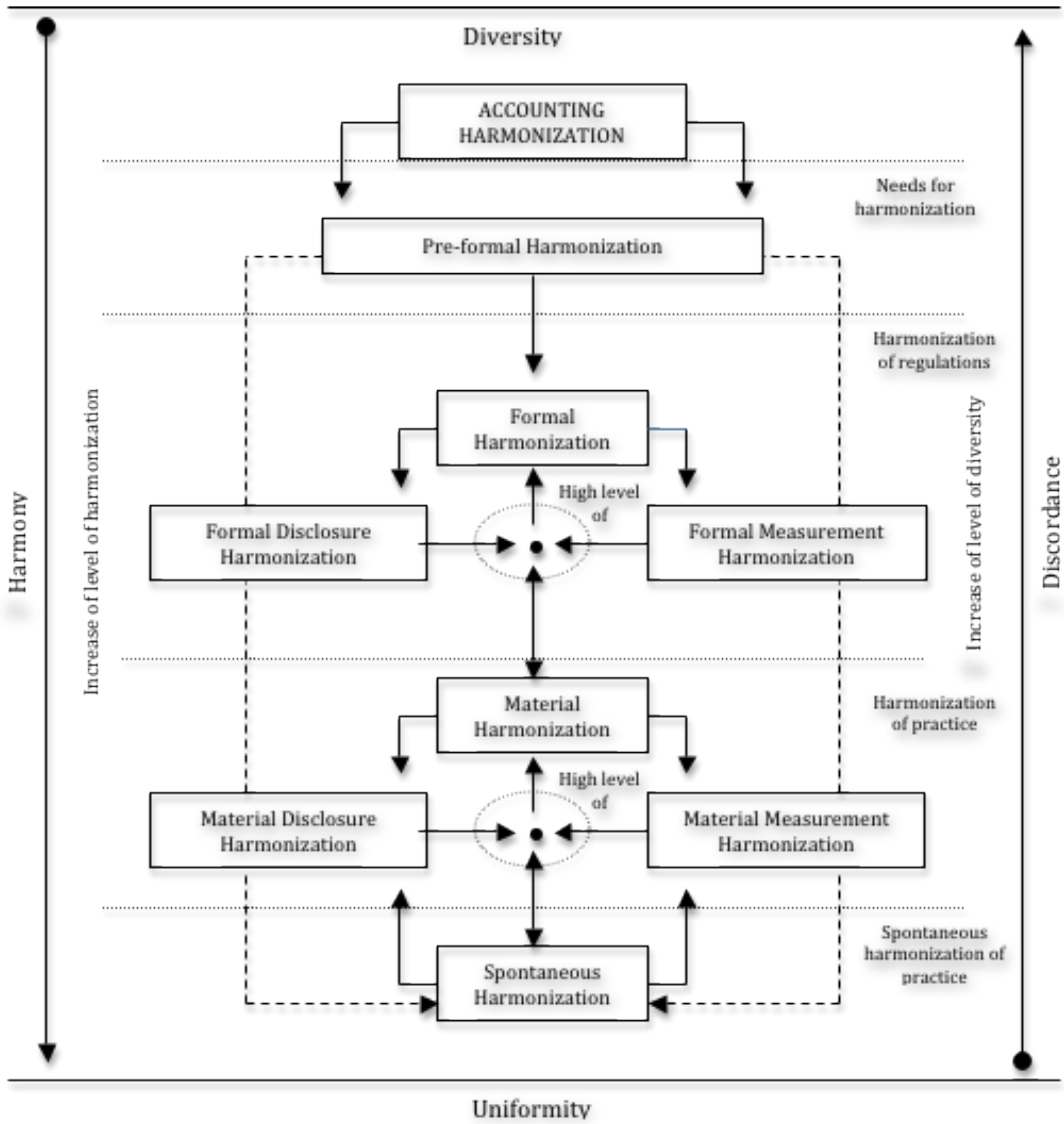

Figure 7: Forms of Harmonization, adapted from Mustata & Napoca (2010)

Van der Tas (1988) further explains that (national) material measurement harmonization can be perceived as an increase in the degree of comparability, i.e. financial reports of more companies can be made more comparable through the use of similar accounting methods. This comparability increases when the result of choice between alternative accounting methods becomes concentrated on one or on only a limited number of accounting methods, even if the number of available methods remained static. Therefore, comparability can be conceived as an increase in the degree of consensus in the choice between alternative accounting methods for an item in financial reports. This increase can be forced, stimulated or spontaneous. When considering international material harmonization, i.e. the international harmonization of financial reports, van der Tas (1988) presents two viewpoints. Firstly, it can be perceived as the comparability of financial reports irrespective of the country in which they are established. Secondly, it can be considered to take place when the opinions on how a specific item should be accounted for are converging in two or more countries.

Further defining, Tay & Parker (1990) add that there are three views how accounting regulations may be strict or less strict. Firstly, a regulation may concern all companies (strict) or only some companies (less strict). Secondly, a regulation may be required by the law (strict) or by a professional accounting standard (less strict). One can expect that compliance with legal regulations is higher than that of standards. Thirdly, a regulation may include a specific definition (strict) or a discretionary one (less strict). Thus, Tay & Parker (1990) conclude that all three views imply that 'strict' is associated with uniformity and 'less strict' with harmony.

4.2 Initiatives towards Harmonization

Standard setters may take different views to the development of auditing standards and thus significant issues related to the role of judgment and to the level of prescription remain. Burns and Fogarty (2010) present two views in the emphasis of standard setting. According to one view, the most important feature of auditing standards is to be capable of inspection and enforcement. However, the concept of 'capable of inspection' is open revolving around the degree to which inspectors and enforcement agencies believe they can sufficiently evaluate and assess auditor's judgments. According to the second view, auditing standards must determine the profound principles of auditing and provide freedom for the application of professional judgment. The international concept and contents of good auditing practice is largely defined by practicing auditors and their professional unions.

Further, the standard setters may have differing views on the relationship between the role of standards and their effect on auditor behavior, which on their part affect the emphasis of the standards themselves. (Burns & Fogarty, 2010) Harmonization of accounting and auditing practices is the ultimate goal of international harmonization efforts. Combarros (2000) pinpoints that in order to achieve harmonization in the role of the statutory auditor much attention should be given to 1) the quality control of statutory audits in the EU, and 2) the independence of the statutory auditor in the EU.

The Fourth and the Seventh Company Law directives were set to provide a harmonized basis for the preparation of the statements of individual and groups of companies in the EU. They have succeeded in bringing about a general increase of accounting standards, enhancing the comparability of accounts and thus conditions for cross-border business as well as allowing the mutual recognition of accounts for purposes of securities exchange quotations throughout the European Union. As the Directives are legally binding, Member states were required to incorporate these Directives into their national legislation. However, the manner in which the desired results are achieved was left to the discretion of the individual countries. The Fourth Directive established the 'true and fair view' principle and the Seventh Directive requires companies to prepare consolidated financial statements outlining the procedures for their preparation. (Doupnik & Perera, 2007) In 2003, the European Parliament approved amendments to the EU's Fourth and Seventh Directives, removing all inconsistencies between the directives and IFRS.

The main goal of the Eight Directive is to harmonize auditor regulation in the EU. All four examined countries have complied with this Directive and its provisions by modifying their company laws and regulations accordingly. However, as noted by Baker et al. (2001), bare compliance with the Directive does not mean that the regulations for statutory auditors would be similar in all countries, i.e. harmonized. The Directive is not exhaustive in the sense that it covers only parts of audit regulation. It focuses mainly on the reduction of barriers in the intra-European trade of audit services and on the minimum training requirements. (Baker et al., 2001; Combarros, 2000) The Directive does not establish any standards, and accordingly they have to be drawn up by the governments of the Member states or regulated within the auditing profession. As noted by Gangolly et al. (2002), "this is evidently incompatible with the objective of attaining uniform quality and procedures". The Directive was revised in 2006.

According to Gangolly et al. (2002), international efforts to harmonize the audit report were culminated in the issuance of ISA 13 in 1983. The purpose of this standard was to: "provide guidance to auditors on the form and content of the auditor's report issued in connection with the independent audit of the financial statements of any entity". This standard has been revised since, and is now known as the ISA 700.

A study conducted by the Fédération des Experts Comptables Européens (FEE) in 1998 found that there is a high level of harmonization as regards audit approach as 'the national standard setters in Europe all look towards International Standards on Auditing in setting their local standards' (Combarros, 2000). The study also found a high correlation between national and international standards, with differences falling into three main categories:

1) Matters relating to local regulation, including different approaches in the auditor's report from those contained in the international standards, inter alia differences concern:
    - ISA 700; The Auditor's Report on financial statements
2) Audit process, including discrepancies between some of the procedures written by the national issuers of audit standards and international standards. Yet, FEE considers that these differences do not cause significant differences in the audit scope in practice;
3) Matters governed by local regulations but not by international standard, grouped in as following:
    - Differences in the legal liability of the auditor;
    - Standards for specific industries in general, in particular with regard to banking and funding management;
    - Generally applicable standards (inter alia audits of the consolidated financial statements of corporate groups).

In 2000, the International Federation of Accountants (IFAC) and the large international accounting firms established the Forum of Firms, also aimed to at raising standards for financial reporting and auditing globally in order to protect the interests of cross-border investors and promote international flows of capital. In their constitution (Forum of Firms Constitution (2007), in Fraser (2010)), they committed to meeting the following obligations for transnational audits:

- Maintain appropriate quality standards in accordance with International Standards on Quality Control issued by the IAASB in addition to relevant national quality control standards and conducts, to the extent not prohibited by national regulation, regular globally coordinated internal quality assurance reviews,

- Have policies and methodologies for the conduct of such audits that are based, to the extent practicable, on ISAs,
- Have policies and methodologies that conform to the IFAC Code of Ethics for Professional Accountants and national code of ethics.

The International Accounting Standards Board (IASB) was created in 2001 as a follower of the IASC. The IASB standards are developed in close relation with stakeholders throughout the world. The members of the IASB are responsible for the development and publication of IFRS. In 2002, the European Commission decided that the IFRS standards are to become mandatory for listed EU companies by 2005 (Troberg, 2007). The importance of IFRS is increasing, as according to the IASB website, "all major economies have set time lines to converge with or adopt IFRSs in the near future". Historically, however, common law countries have had a high influence on the IASB standards (Morais & Fialho, 2008). In addition, the IASB has an interpretative body, the IFRS Interpretations Committee, the purpose of which is to review widespread accounting issues within the context of current IFRSs on a timely basis and to provide authoritative guidance. The Committee cooperates with similar national bodies.

A joint conceptual framework project, the Norwalk Agreement, of the IASB and the Financial Accounting Standards Board (FASB) was initiated in 2002. A common framework is a crucial pre-requisite for common standards. As the IASB's agenda is now aligned with that of the FASB, new global principles-standards are being developed on a joint basis. The purpose of the cooperation is to achieve convergence of IFRSs and US GAAP. (Troberg, 2007; Whittington, 2008) In 2006, the commitment of the boards was further strengthened through specific milestones to be reached by 2008. In 2007, the US Securities and Exchange Commission (SEC) allowed non-US companies registered in the US to solely comply with IFRSs, thus not having to reconcile their financial reports with US GAAP. Simultaneously, the SEC published a proposed roadmap on the adoption of IFRSs for domestic US companies. In 2009, the G20 leaders showed their support to this international convergence and demanded the standard-setters to double their efforts to complete the project by June 2011. (IASB website) Apparently European financial reporting is moving more and more towards the American model, meaning that the importance of investors and stock exchanges is accentuated (Troberg, 2007).

However, this convergence project is not an easy task. As far as accounting culture creates different views to the appropriate content of financial reports, it represents a fundamental and possibly difficult source of disagreement about IFRS. It needs to be understood and resolved if IFRSs are to be interpreted and implemented in a consistent manner across different constituencies. Nevertheless, signing up constituencies to the conceptual framework is a crucial step towards true harmonization as well as providing consistency between standards and providing guidance in circumstances not covered by existing standards. (Whittington, 2008) Morais and Fialho (2008) agree and note that "previous studies have shown that harmonized accounting standards do not necessarily lead to harmonized accounting practices".

According to a 2008 European Commission Communication: "The wide consultation, which has taken place on the matter of the statutory audit has shown general agreement that the audit function is important, that the EU needs a reference framework in the auditing field and that such framework should be based as far as possible on existing international standards." (Combarros, 2000) In their 2008 position paper, the IFAC promoted the concept of 'an audit is an audit', meaning that while audit approaches may vary, the auditing standards and the level of assurance the auditor is required to obtain, should not. (Fraser, 2010)

As a result of the commitments by the largest networks, there will and continue to be de facto adoption of the ISAs for the vast majority of all companies in the world, irrespective of national requirements (Fraser, 2010). However, as Fraser (2010) notes, this harmonization is not clear to the readers of the audit reports as they refer to various national standards. Gangolly et al. (2002) found that the audit reports issued by the Big 4 accounting firms tend to be better harmonized than those of other auditing firms due to economics scale and reduced audit costs. The large auditing networks have worked their part towards harmonization as they began to ensure that their global methodologies complied with the international auditing standards as a base line minimum as they began to emerge and gain credibility. (Fraser, 2010)

4.3 Main Changes in International Auditing Regulations

As noted previously, auditing standards are key to providing high quality audits. However, there are no agreed on auditing standards in the European Union to date although there is high agreement in Europe on the need to develop the quality and comparability of financial statement audits and auditor's reports on the basis of ISAs. (FEE, 2001) Neither is there a global audit inspection or enforcement process. Each jurisdiction therefore has its own approach to inspection and enforcement. (Burns & Fogarty, 2010) This chapter discusses the main international standards concerning auditing in the EU as well as the main initiatives towards harmonized international standards.

ISAs are described as a single set of high quality, credible audit and reporting standards that will lead to enhanced confidence in the overall reporting system. They combine principles and rules in a structure that first defines the objective of an audit, the overall objective of the auditor and the objectives of the auditor for each standard. They are then followed by requirements supporting achievement of the objective and provide application guidance for the requirements. Thus, ISAs tend to avoid detailed and prescriptive requirements to contribute to the sound application of professional judgment in order to achieve the objects. (Burns & Fogarty, 2010) However, despite the credibility of the IAASB, national and regional legislators have not been too eager to move rapidly to adopting these standards, Fraser (2010) presents two possible explanations to their reluctance: 1) the phenomenon of 'not invented here', and 2) some countries find it hard to entrust their standard-setting to a private independent body, which is not under the direct control of a national legislative process.

According to a FEE proposal (2001), compliance with the ISAs is presumed to mean higher benefits regarding internal and capital market efficiency, respect for the subsidiarity principle and enhanced use of technical recourses. The council proposes therefore that "by 2005, national auditing standards in the European Union should require auditors of financial statements to: 1) perform audit procedures that comply with ISAs, 2) report on financial statements in accordance with ISAs, and 3) perform additional audit procedures and report on additional matters in response to specific legal, regulatory or other needs established at a national level".

According to a study conducted by the Fédération des Experts Comptables Européens (the European Federation of Accountants, FEE) that European national standards are substantially in line with ISAs. However, in a later FEE study, interviews showed that there is a notable diversity in the wordings of audit reports among different EU countries (FEE, 1998 & 2000 in Garcia-Benau & Zorio, 2004). Garcia-Benau and Zorio (2004) therefore reflect that this study could support the idea that a seemingly satisfactory of formal harmonization in the EU does not automatically suggest a good level of material harmonization. Van der Tas (1992) agrees and notes that "international harmonization on the one hand and compliance or observance with IASs on the other are related in the sense that setting international standards may further harmonization. But they are two very different phenomena."

In 1994, the IFAC issued "The Auditor's Report on Financial Statements" (ISA 700) as a response to growing concern related to the expectations gap. The main purpose of the standard is to provide guidance on the form and content of the auditor's report. The standard was revised in 2003. It can be found in Appendix 5. According to King (1999), the terms 'true and fair view' and 'present fairly, in all material respects' are deemed equivalent. The described ISA also indicates that an unqualified opinion means that 1) the auditor has concluded that the financial statements give a true and fair view, or are presented fairly in accordance with the financial reporting framework, and 2) any deviation from accounting principles or their application has been properly determined and disclosed in the financial statements. According to ISA 700 "the auditor's report should clearly indicate the financial reporting framework used to prepare the financial statements". However, the previous ISA 13 simply suggested that "the audit report stated the accounting framework used in the preparation of the financial information of the company". (Garcia-Benau & Zorio, 2004)

All members of the European Union are compelled to comply with the EU Directive No. 2006/43/EC (Eight Directive). The directive requires that all statutory audits of annual and consolidated accounts are to be executed in accordance with international auditing standards as adopted by the European Commission. The Directive aims at high-level, although not full, harmonization of statutory audit requirements. (2006/43/EC)

H5: The Eight Directive has had a harmonizing effect on the audit reports.

In spring 2009, the IFAC finished its extensive renewal of all 36 ISAs, the Clarity project. The purpose of the project was to clarify the standards and enhance their readability and understandability. The language and structure of the standards was developed and among others, a goal was to divide the requirements of the auditors from the implementation guidelines. Further, contentual changes were introduced to about a half of the standards. The new standards are to be implemented on accounting periods commencing on 15.12.2009 or later. (eStandardsForum, 26.10.2010) As the enquiries for a clearer definition as to what auditors are required to do in order to comply with the standards, the clarified ISAs were developed and will be effective for audits of financial periods beginning on or after 15 December 2009, thus not making it to the scope of the study. (Fraser, 2010)

4.4 Theoretical Framework

This chapter will draw conclusions from the theoretical part of this paper. As discussed above, auditing has set a strong foothold in the functioning of developed economic environments. Based on the audits, auditors are required to render an opinion on the financial statements as an auditor's report. However, due to various national dynamics, the audit processes and thus audit reports differ from each other. There have been several harmonization initiatives to reduce these differences. The purpose of the following chapter is to measure, whether these initiatives have been successful and if the audit reports have become more alike.

According Troberg (2007), there are various factors that have affected national reporting practices. He points out four institutional factors, which have had a significant influence in the development of these practices: 1) providers of finance, 2) tax system, 3) role of accountancy profession, and 4) legal system.

Further, Mustata and Napoca (2010) found eight determining factors resulting accounting diversity:

1) the degree of economic integration,
2) the finance sources,
3) the politic and legal system,
4) the fiscal system,

5) the accountant status,
6) the culture,
7) the language of accounting, and
8) any other external influences.

The purpose of this chapter is to present a framework on the dynamics affecting the audit reports. Previous studies have concluded that there are a variety of factors that affect national reporting practices. Apart from those that have been discussed previously in the text, there are two more. Based on the theories presented in the paper, one can assume that there are several factors influencing the structure and development of national audit reports.

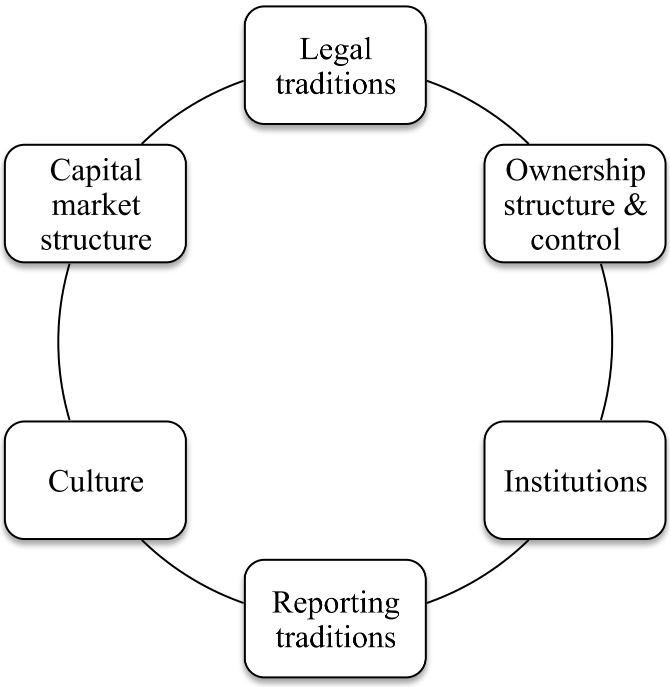

Figure 8: Theoretical framework, adapted from Weimer & Pape (1999)

This figure will be updated later based on the empirical results. In the final chapter, the theory discussed above will be compared with the findings of the empirical study and conclusions will be drawn. In addition to studying national and international development of the audit reports, this paper will also look into whether the reports have approached each other, i.e. harmonized.

5 METHODOLOGY

This chapter will discuss the design and data of the empirical research. The study will be conducted as a quantitative analysis. The chapter will begin by introducing the research sample and how the data was collected. It will then progress to presenting the analyzed companies and their development. The rest of the chapter will discuss the elements of audit reports and the construction of indices.

5.1 Data Collection

The empirical study is based on the evaluation of audit reports of 20 publicly listed companies in four European countries, Finland, France, Germany and United Kingdom (Table 2). Each of the companies is listed on their national stock exchange and possibly on others, such as NASDAQ. The companies also represent five different industries. The industries were defined according to a loose adaption of the Standard Industrial Classification TOL 2008 by Statistics Finland. The companies were selected according to their size and the availability of the annual reports from the Forbes 2000 list. However, not all Finnish companies were big enough to make it to the Forbes list, so they were selected from the 2000 biggest Finnish companies list ranked by Kauppalehti. The size and public listing of a company were determining factors, as they should ensure that national and international regulations are followed.

Further, companies performing in the financial industry (banking, brokerage and insurance) were excluded because the regulation in these industries and thus the contents of the audit reports may vary from the other industries. Based on these exclusions, the sample size was set to 200 audit reports. The sample size was chosen to be large enough to have some expectation of being representative, but yet small enough to allow thorough analysis of the audit reports taking the limited resources into account. The audit reports were collected from the companies' websites between the years 2000-2009.

Company	Founded	Country of Domicile	Industry
Atria Oyj	1991	Finland	Consumer goods
AstraZeneca plc	1999	United Kingdom	Professional & tech. activities
BASF SE	1865	Germany	Industrials
Beiersdorf AG	1882	Germany	Consumer goods
BMW AG	1916	Germany	Manufacturing
Centrica plc	1997	United Kingdom	Power & Gas
Groupe Danone S.A.	1966	France	Consumer goods
E.ON AG	2000	Germany	Power & Gas
Fortum Oyj	1998	Finland	Power & Gas
HeidelbergCement AG	1874	Germany	Professional & tech. activities
Huhtamäki Oyj	1920	Finland	Professional & tech. activities
Johnson Matthey plc	1891	United Kingdom	Industrials
Kone Oyj	1910	Finland	Manufacturing
Konecranes Oyj	1994	Finland	Industrials
Lafarge S.A	1884	France	Manufacturing
Nexans S.A	1994	France	Industrials
SABMiller plc	1886	United Kingdom	Consumer goods
Schneider Electrics S.A.	1836	France	Power & Gas
Smith & Nephew plc	1937	United Kingdom	Manufacturing
Veolia Environnement S.A.	1853	France	Professional & tech. activities

Table 2: Analyzed companies

Another condition for the sample was that a company must be audited by one of the Big Four auditing firms, KPMG, Ernst & Young, PriceWaterHouseCoopers or Deloitte Touche Tohmatsu (Table 2). This condition was set to find out whether the auditor plays a role in the form of the audit report. As the selected companies have all been audited by the Big Four, one could also expect that there may be some similarities in the audit reports varying by the auditing firm.

Two Finnish companies and two German companies changed their auditors in 2006. (Table 3) The auditors of French companies changed more frequently. Due to the joint audit requirement, all French companies have been audited by two auditing firms. For the purposes of this study, the Table 3 takes into account the auditor or auditing network, whose signature is presented first in the audit reports. The French auditing group Mazars is depicted with MZ. However, these changes of auditing networks did not seemingly affect the audit reports. Other companies have had the same auditors from 2000 to 2009. It seems that the applied reporting frameworks have had a stronger harmonizing effect in the audit reports than the audit firms.

Unlike their counterparts, none of the British companies changed auditors during the analyzed period. However, the sample does not include any companies audited by Deloitte due to limited availability of resources. Only few companies have included financial statements for a longer period than the latest reporting period minus five periods. The combination of the conditions based on the selection of companies resulted in a compromise of not having one of the Big 4 auditors in the sample of British companies.

Finland	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Atria	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC
Fortum	PWC	PWC	PWC	PWC	PWC	PWC	Deloitte	Deloitte	Deloitte	Deloitte
Huhtamäki	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG
Kone	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC
Konecranes	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	E&Y	E&Y	E&Y	E&Y

France	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Danone	MZ	MZ	MZ	PWC	PWC	PWC	PWC	MZ	MZ	MZ
Lafarge	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte
Nexans	E&Y	E&Y	E&Y	KPMG	E&Y	KPMG	PWC	PWC	PWC	PWC
Schneider	E&Y	E&Y	E&Y	E&Y	MG	MG	MG	MG	MG	MG
Veolia	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	KPMG	KPMG	KPMG	KPMG

Germany	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
BASF	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	KPMG	KPMG	KPMG	KPMG
Beiersdorf	BDO	BDO	BDO	BDO	BDO	BDO	E&Y	E&Y	E&Y	E&Y
BMW	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG
E.ON	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC
Heidelberg	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y

United Kingdom	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
AstraZeneca	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG
Centrica	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC
Johnson Matthey	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG
SABMiller	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC
Smith & Nephew	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y

Table 3: Auditors of companies by country

5.2 Research Design

To determine actual changes in the audit reports and the dynamics behind them, the study will focus on audit reports on consolidated financial statements and on unmodified opinions thereof. This decision was made to ensure the application of the latest regulations and accuracy. The research will ignore additional comments or remarks by the auditors, as their main purpose is to draw the readers' attention to specific issues without qualifying the audit report. They are based on the auditors' own judgment and expertise and thus are not in the main focus of the study as they can be difficult to compare. In order to avoid bias affecting the indices, an equal number of observation in each country in each year were ensured. To obtain an overall picture of audit reports, x items were identified as representative of the essence of audit reporting. However, the determination of the number of possible treatments incorporated in the model for calculating indices can be highly judgmental.

The research will begin with a word count performed on the audit reports to trace changes in the wording and structure of the reports. The word counts will exclude the time, place and signatures of the auditors as well as the headings so as to focus more on the actual text of the audit reports. Further, additional comments or notes that do not affect the opinion of the audit report will be outstripped. The word count will give initial evidence on how the reports have changed and give direction for the quantitative analysis. Further, the reports of a company are read through and the elements of the audit report are quantified into excel format. When all of the texts have been quantified, measurement indices will be built and used to analyze the development and harmonization of the audit reports. The changes found in the audit reports will then be mirrored with the changes in national and international legislation and regulations. Finally, a framework will be built to present the dynamics behind the changes in the audit reports.

However, the measurement of harmonization is not an easy task. Van der Tas (1992) notes that even if compliance with international standards would be high, it does not necessarily mean that the level of harmony is high as the standards may leave options, each of which are applied by companies. Accordingly, even if the compliance is low the degree of harmony may be high if all companies exercise the same method, which is not allowed by the standard. However, according to Tay & Parker (1990), showing cause-and-effect relations between legal regulations and the use of accounting methods and/or the disclosure of some information is easier than between professional regulations and accounting practices. Fontes et al. (2005 add that the majority of studies regarding accounting harmonization have focused on material harmonization. They also point out however that it would be important to pay more attention towards formal harmonization as the accounting world and EU in particular is focused in achieving convergence in a formal sense. These attempts are assisted by the IASB, which is cooperating with national standard setting bodies.

As stated earlier, accounting and auditing are being affected by a multitude of factors, which may complicate the identification of the causal effects of the respective changes in audit reports. Further complicating matters is the fact that the analysis is dependent on the disclosures provided in the audit reports and thus the used indices will measure harmony of disclosure. This provides a problem, as treating non-disclosure as a specific treatment may provide a false impression of harmony in cases where there are high levels of non-disclosure. In addition, the extent to which companies use terms synonymously is not always clear. (Aisbitt, 2001) Aisbitt (2001) divides difficulties related to the use and analysis of indices into two main groups: 1) problems relating to causal inference, and 2) problems relating to properties of indices. According to her, it has been claimed that the interplay of these issues complicates the use and interpretation of the indices to a great extent.

5.3 The C-Index

This chapter will begin with a discussion of the main elements and description of an audit report, which then will be used as the variables. These elements will then be compared to each other with the use of indices, based on the indices originally developed by van der Tas in 1988. Although the indices have faced criticism in the literature, they do have advantages: they are of simple character and have high accuracy of furnished information in comparison to element of descriptive statistics nature. As the purpose of this study is to determine trends in the development and harmonization of the audit report, the indices used provide reasonable basis for the analysis. These indices will be used to measure the harmonization and development of the audit reports throughout the ten-year time span. The construction of the indices and their description will be presented in the latter part of the chapter.

A number of indices have been developed to measure the extent of de facto harmony of financial reporting within and between countries at certain dates and to evaluate the success of harmonization efforts (Aisbitt, 2001; Archer et al., 1995). It should be possible to quantify harmonization, by comparing values of the indices longitudinally. Further, Mustata and Matis (2010) identify two methods for measuring harmonization: 1) those that derive from the indices developed by van der Tas (1988) and 2) newer measurement techniques, such as the phi-square and other statistical methods. This study will focus on the first type of indices. As they were originally developed to measure accounting harmonization, some adaptations will be made.

According to van der Tas (1988), 'comparability increases when the result of the choice that companies make between alternative accounting methods becomes concentrated on one or only a limited number of accounting methods, even where the number of available methods remains the same. Thus, comparability can be considered as an increase in the degree of consensus concerning the choice between the alternative methods of accounting for an time in the financial reports.' Van der Tas (1992) continues that the Hirschman-Herfindahl index (H-index) was chosen to measure harmony and harmonization. According to van der Tas (1988) the H-index measures harmonization within countries. It ranges from 0 (no harmony, an infinite number of alternative methods all with the same frequency) to 1 (all companies using the same method). The movements of this index depict the degree of (dis-) harmonization. The index adds the square of relative frequencies of each of the applied methods and thus:

$$H = \sum_{i=1}^{n} p_i^2$$

where:

H = Herfindahl index.

n = number of alternative auditing methods.

p_i = relative frequency of accounting method i.

Van der Tas (1988) notes however that the level of harmony is dependent not only on the number of alternative accounting methods used, but also on the extent to which a method is applied. McLeay & Neal (1999) agree and state that comparability of financial reports is subject to availability of alternative accounting treatments and use of appropriate methods by individual firms rather than on a universal application of a uniform accounting method. However, harmonization should not be conceived as synonymous with strict uniformity, but rather as dependent on different circumstances (Van der Tas, 1988; McLeay & Neal, 1999). Thus, international harmony in accounting should be seen as a state in which firms all over the world are able to use the same internationally recognized accounting treatment appropriate to their circumstances without opposing requirements from their local accounting regulations or practices.

In order to take these issues into account, van der Tas (1988) introduced the C-index. It measures harmonization between countries: “It divides the number of compatible pairs of financial reports by the total number of possible comparisons.” Further, two financial reports are comparable if they are based on the same accounting method. Archer et al. (1998) further elaborate on the comparability and state that: ”the lowest level of comparability exists when the accounting methods are assumed to be distributed equiprobably over the companies, the outcome of a random selection of accounting policies. (...) Comparability increases when the choices made by companies converge towards a generally accepted method or when the number of accounting methods in use is reduced”. Thus, the total number of financial reports must be subdivided into classes of financial reports with the same accounting in respect of a specific item, if no multiple reporting takes place. The financial reports are only comparable within these classes, not between. The formula for the C-index is:

$$C = \frac{(\sum_{i=1}^{i} a_i^2) - n}{n^2 - n}$$

The C Index is described to answer three major requests: 1) the quantification of the harmony degree is directly associated to the comparability degree, 2) it has the ability to take into account several reporting systems and the data afferent to the reconciliations between diverse accounting treatments, and 3) it offers the possibility to calculate the degree of significance of the harmony level modifications, based on some relevant significance tests. Additionally, the index measures the level of comparability for each element from the financial reports, starting from the number of situations that are comparable at the level of analyzed elements. An increase in the degree of harmonization can be associated with an increase in the number of companies applying the same method, even if the number of applied alternative methods remains the same or increases. (Aisbitt, 2001; Mustata & Matis, 2010)

One interpretation of the C index is based on the idea that the degree to which the selected entities apply the same measuring method is calculated by "dividing the number of pair-companies that apply the same measuring method, having in view the typology of the activities pursued by these companies, to the number of pair-companies existent at the level of the entire sphere of research". Aisbitt (2001) states that the measuring systems based on this view represent a highly important scientific measure in the evolution of the material harmonization degree measurement studies. Additionally, systems based on the concepts of similarity and correlation can be used for the same purposes. All of the mentioned systems tend to have a high degree of reliability.

Archer et al. (1995) further developed the C-index as they recognized the need to decompose it into within country and between country components to highlight the dangers of assuming that all companies within a country report similar items in a similar way. According to them, the value of the index can be interpreted as the probability that two randomly selected companies will report comparable financial information. The C index is a measure of accounting harmony (a state) in a population of companies, whereas the change in the value of the index over time is a measure of accounting harmonization (a process). It measures the comparability of audit reports on an item-by-item basis. However, it does not measure their overall comparability.

According to Archer et al. (1995), the number of combinations of n companies taken r at a time is given by

$$\binom{n}{r} = \frac{n!}{(n-r)!r!}$$

which can be simplified into $\frac{1}{2}n(n-1)$ for pairwise comparisons. Further, x_j will be used to indicate the number of companies selecting the jth of 1 to J audit reporting methods, and the number of pairwise companies amongst the x_j companies using that particular method is given by

$$\binom{x_j}{2} = \frac{1}{2} x_j (x_j - 1)$$

According to Archer et al. (1995): "The C index is a measure of the total number of feasible pairwise comparisons expressed as a proportion of the maximum possible number of comparisons that could be made in the event that all companies were to choose the same accounting method". Therefore, the index provides a measure of uniformity in audit reporting policy choice at any given point in time, and the change in the index provides a measure of convergence of audit reporting policy choice for a particular audit report item through time.

Originally, van der Tas (1988) introduced the I-index to measure international or between-country harmonization. However, Archer et al. (1995) decomposed the C-index in a way that enabled the distinction between comparability within and between countries. Thus, the decomposition of a single index is able to provide a basis for a distinction between 1) the impact of standardization of audit reporting methods on interfirm comparisons within countries and 2) the effects of harmonization on international interfirm comparisons.

The number of pairwise comparisons that calculable in the ith country amongst companies selecting the jth audit reporting method is $\frac{1}{2} x_{ij}(x_{ij} - 1)$. Thus, within-country comparability, the total amount of comparisons available between companies within the same countries is given by the sum of the companies within the same countries. It can be expressed as:

$$\frac{1}{2} \sum_i \sum_j (x_{ij}(x_{ij} - 1))$$

The comparability index may then be conducted by dividing the number of feasible pairwise combinations by their respective maxima and by multiplying all terms by 2. Therefore:

Within-country comparability index

$$\frac{\sum_i \sum_j (x_{ij}(x_{ij} - 1))}{\sum_i (x_{i+}(x_{i+} - 1))}$$

The number of pairwise comparisons available for companies selecting the jth audit reporting method but operating in different countries is given by the sum of the products between cells within each category of audit reporting method, divided by two as these are combinations and not permutations. This will be referred to as between-country comparability and it can be expressed as: $\frac{1}{2}\sum_i \sum_j (x_{ij}(x_{+j} - x_{ij}))$.

The index for between-country comparability is constructed similarly as the previous index and thus:

Between-country comparability index

$$\frac{\sum_i \sum_j (x_{ij}(x_{+j} - x_{ij}))}{\sum_i (x_{i+}(x_{++} - x_{i+}))}$$

Moreover, the total number of feasible pairwise comparisons is the sum of the within-country and between-country totals, as follows:

$$\frac{1}{2}\sum_i \sum_j (x_{ij}(x_{ij} - 1)) + \frac{1}{2}\sum_i \sum_j (x_{ij}(x_{+j} - x_{ij})) = \frac{1}{2}\sum_j (x_{+j}(x_{+j} - 1))$$

To be able to measure harmonization of the audit reports, the indices must be calculated separately for the different audit report items. This requires that the comparable items of the audit reports must be identified along with the different reporting methods. The harmonization of the audit reports will be considered for six audit report elements. These elements were selected because they represent the choices that auditors and preparers of the financial statements have had to make to be able to perform the audit. The elements and their alternatives are depicted in Table XX.

However, the following chapter will also depict and analyze the overall development of the audit reports nationally considering all of their elements. For simplicity and calculatory reasons, only six elements were accepted as a basis for the construction of the C-index. The international evaluation of the overall harmonization will consist of the use of between- and within-country comparability indices, whereas the country-specific harmonization will only use the within-country comparability index, the basic form of the C-index.

Financial statements audited
Identified
Not identified

Financial reporting framework
Not disclosed
US GAAP
Local GAAP
Additional requirements by national laws & regulations
IAS
IFRS

Framework for audit
US GAAS
Local GAAS
National laws & regulations
Good local audit practice / profession's ethical guidance
Standards of PCAOB
International Standards on Auditing (ISAs)

How audit conducted
Not specified
Test basis
Procedures according to the auditor's judgment

Items assessed in the progress of audit
Significant estimates & judgments made by the directors
Appropriateness of accounting policies, consistency & adequate disclosure
Content & manner of presentation of the financial statements
Bookkeeping / auditing principles
Risk

Audit opinion
True & fair view
Correct & sufficient information
Present fairly

Table 4: Analyzed audit report elements

6 EMPIRICAL RESULTS

This chapter discusses the main findings of the empirical research. It begins with an outlook on the overall harmonization within and between Finland, France, Germany and the United Kingdom. This chapter presents the main findings of the analysis comprised with the assistance of the C-index. After the overall view on harmonization, the chapter will continue with national evaluations of development and harmonization. The results should be interpreted as follows: an increase in the C-index value proves a concentration of opinion for a certain method as well as an increase in the degree of consensus at the level of auditing practice. The changes in contents and structures will then be paired with respective changes in national and international regulations.

6.1 Overall Harmonization of Countries

This chapter presents a view to the overall harmonization to the sample, deriving from empirical results gathered from the four countries. The six analyzed elements will be discussed separately and the harmonization thereof will be examined. The tables and graphs presented introduce the C-index divided into measurements of within-country comparability and between-country comparability. These indices together present the total comparability. Despite the limited sample size, the results of the study can be interpreted as trends in the development and harmonization of the audit report.

All of the examined audit reports follow a similar structure by beginning with an explanation of what has been audited and what regulations is the audit based on. This part may also include an explanation of responsibilities. The following part of the reports comprise of what an audit includes and how the audit has been conducted. The last part of the reports states the auditor’s opinion on the statements and may also include opinions relating to management reports and administration. Finnish audit reports also commented on the discharge from liability and proposals made by the Board of directors.

Overall, it seems that the auditors opt for similar practices in the preparation of their audit reports irrespective of their country. As discussed earlier, one reason for this is probably the use of the Big Four auditors, which promote a practice of ‘one firm-worldwide’ (Arnold et al., 2008). It would be interesting to measure whether the trends of harmonization have been as notable in audit reports prepared by auditors from smaller companies. However, this type of examination is outside the scope of this study. What could be seen from the sample is that there are no profound differences between the reports of audit reports. The differences vary rather from national dynamics than from the auditors.

All countries provide an audit report containing three parts, the introduction, the scope and the opinion. The level of detail varies as well as the scope of the audit. German and British audit reports provided the most detailed audit reports, although it could be seen that the Finnish audit reports were also moving towards a more explicatory model. This could be linked with an attempt to reduce the expectations gap as well as to educate the users of the audit report.

As visible in both Table 5 and Figure 9, the within-country index presents a notable increase from 2005 onwards. The between-country index presents also an increase towards the end of the examined time frame. However, as none of the French audit reports have identified their audited statements, the index remains rather low, thus affecting the total comparability.

Disclosure of financial statements	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Financial statements not identified	10	8	8	7	9	9	8	9	6	6
Finland	0	0	0	1	2	5	4	3	0	0
France	5	5	4	2	3	3	3	5	5	5
Germany	2	1	2	2	2	1	1	1	1	1
UK	3	2	2	2	2	0	0	0	0	0
Financial statements identified	10	12	12	13	11	11	12	11	14	14
Finland	5	5	5	4	3	0	1	2	5	5
France	0	0	1	3	2	2	2	0	0	0
Germany	3	4	3	3	3	4	4	4	4	4
UK	2	3	3	3	3	5	5	5	5	5
Within-country comparability	56	60	48	36	32	60	52	60	72	72
Between-country comparability	124	128	140	162	150	122	136	122	140	140
Within-country index	0,700	0,750	0,600	0,450	0,400	0,750	0,650	0,750	0,900	0,900
Between-country index	0,413	0,427	0,467	0,540	0,500	0,407	0,453	0,407	0,467	0,467
Total comparability index	0,474	0,495	0,495	0,521	0,479	0,479	0,495	0,479	0,558	0,558

Table 5: Harmonization of the disclosure of financial statements

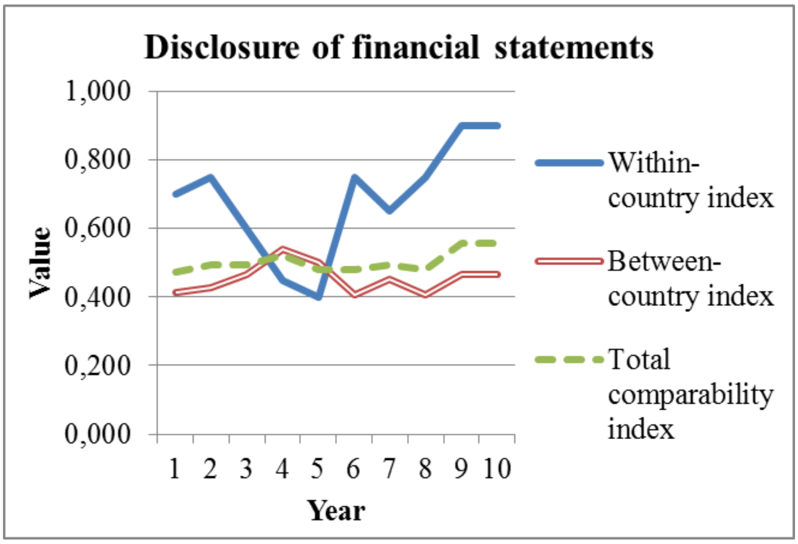

Figure 9: Harmonization of the disclosure of financial statements

The mandatory implementation of the IFRS standards for all publicly traded European companies can be seen as a high increase in the comparability of both within-country and between-country indices. (Table 6, Figure 10). However, the within-country index has been relatively high for all years due to national legislation. It seems that European Union has had a strong effect on the audit reports in this sense. In terms of van der Tas (1988), one could say that formal harmonization has led to material harmonization in the financial reporting framework. In addition, the majority of the countries require additional disclosures from their audit reports in their legislation to satisfy the needs of national requirements.

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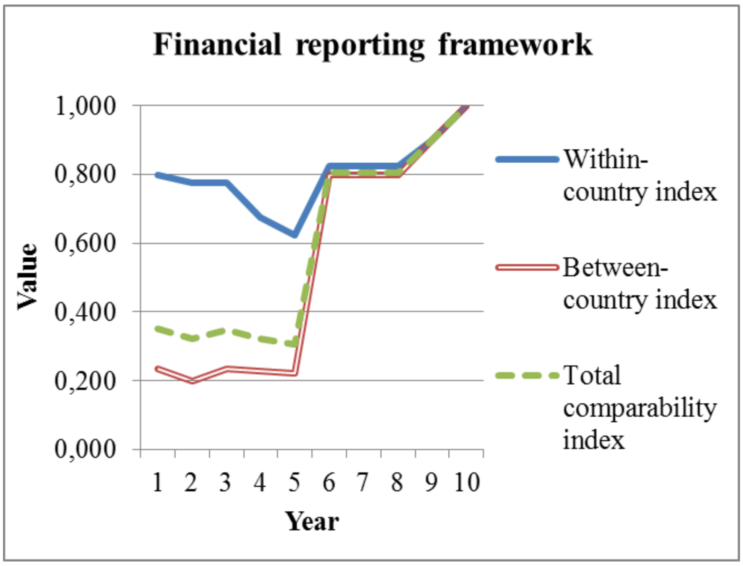

Figure 10: Harmonization of the financial reporting framework

Financial reporting framework	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not disclosed	7	6	7	6	5	1	1	1	1	0
Finland	5	5	5	4	3	0	0	0	0	0
France	0	0	0	0	0	0	0	0	0	0
Germany	2	1	2	2	2	1	1	1	1	0
UK	0	0	0	0	0	0	0	0	0	0
US GAAP	1	1	1	1	1	1	1	1	0	0
Finland	0	0	0	0	0	0	0	0	0	0
France	0	0	0	0	0	0	0	0	0	0
Germany	1	1	1	1	1	1	1	1	0	0
UK	0	0	0	0	0	0	0	0	0	0
Local GAAP	10	10	10	10	10	0	0	0	0	0
Finland	0	0	0	0	0	0	0	0	0	0
France	5	5	5	5	5	0	0	0	0	0
Germany	0	0	0	0	0	0	0	0	0	0
UK	5	5	5	5	5	0	0	0	0	0
Local Additional requirements	2	1	2	3	4	14	15	15	15	15
Finland	0	0	0	1	2	5	5	5	5	5
France	0	0	0	0	0	0	0	0	0	0
Germany	2	1	2	2	2	4	5	5	5	5
UK	0	0	0	0	0	5	5	5	5	5
IAS	2	2	1	1	1	0	0	0	0	0
Finland	0	0	0	0	0	0	0	0	0	0
France	0	0	0	0	0	0	0	0	0	0
Germany	2	2	1	1	1	0	0	0	0	0
UK	0	0	0	0	0	0	0	0	0	0
IFRS	0	1	1	2	3	18	18	18	19	20
Finland	0	0	0	1	2	5	5	5	5	5
France	0	0	0	0	0	5	5	5	5	5
Germany	0	1	1	1	1	3	3	3	4	5
UK	0	0	0	0	0	5	5	5	5	5
Within-country comparability	64	62	62	54	50	66	66	66	72	80
Between-country comparability	70	60	70	68	66	240	240	240	270	300
Within-country index	0,800	0,775	0,775	0,675	0,625	0,825	0,825	0,825	0,900	1,000
Between-country index	0,233	0,200	0,233	0,227	0,220	0,800	0,800	0,800	0,900	1,000
Total comparability index	0,353	0,321	0,347	0,321	0,305	0,805	0,805	0,805	0,900	1,000

Table 6: Harmonization of the financial reporting framework

As depicted in Table 7 and Figure 11, the used auditing standards present a rather high comparability within countries. However, due to national auditing standards, the between-country comparability remains quite low, although increasing from 2006 onwards. However, as noted previously, the international standards on auditing (ISAs) are used as a basis for national auditing standards and thus, harmonization in the auditing practices should be visible, especially after the mandatory implementation of the revised Eight Directive in 2006.

It remains to be seen, whether the ISAs gain a similar position in the regulation of auditing as the IFRS have gained in accounting. As discussed previously, harmonization of auditing standards and practices hold several benefits.

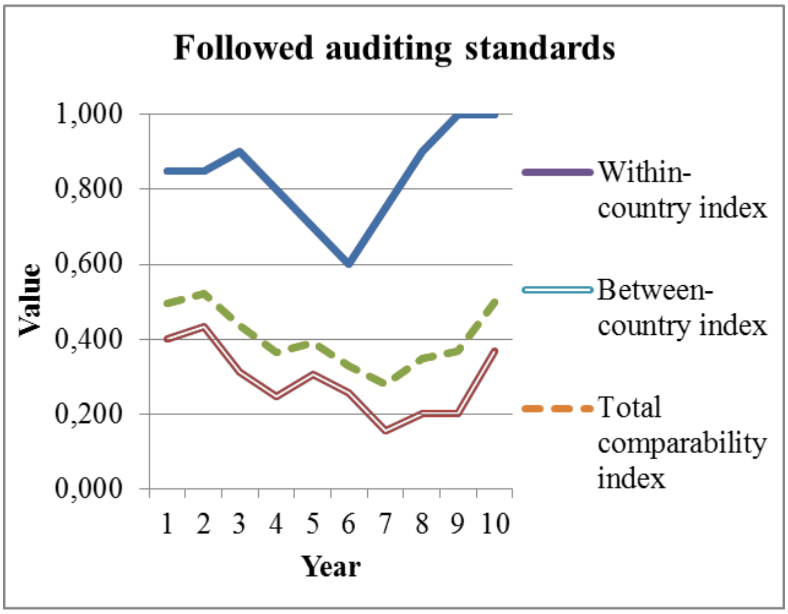

Figure 11: Harmonization of the followed auditing standards

Followed auditing standards	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
US GAAS	1	1	3	3	1	0	0	0	0	0
Finland	0	0	0	0	0	0	0	0	0	0
France	0	0	1	2	0	0	0	0	0	0
Germany	1	1	2	1	1	0	0	0	0	0
UK	0	0	0	0	0	0	0	0	0	0
Local GAAS	12	13	10	10	10	10	9	9	5	5
Finland	5	5	5	5	4	4	4	4	0	0
France	2	3	0	0	1	1	0	0	0	0
Germany	5	5	5	5	5	5	5	5	5	5
UK	0	0	0	0	0	0	0	0	0	0
National laws & Regulations	2	2	2	5	6	11	13	15	15	15
Finland	0	0	0	0	0	0	0	0	0	0
France	0	0	0	2	3	3	3	5	5	5
Germany	2	2	2	3	3	4	5	5	5	5
UK	0	0	0	0	0	4	5	5	5	5
Good (local) audit practice	8	7	9	7	8	4	4	6	10	15
Finland	0	0	0	0	1	1	1	1	5	5
France	3	2	4	2	2	2	3	5	5	5
Germany	0	0	0	0	0	0	0	0	0	0
UK	5	5	5	5	5	1	0	0	0	5
Standards of PCAOB	0	0	0	1	2	3	2	0	0	0
Finland	0	0	0	0	0	0	0	0	0	0
France	0	0	0	1	2	2	2	0	0	0
Germany	0	0	0	0	0	1	0	0	0	0
UK	0	0	0	0	0	0	0	0	0	0
ISA	2	2	2	2	2	5	5	6	6	6
Finland	0	0	0	0	0	0	0	0	0	0
France	0	0	0	0	0	0	0	0	0	0
Germany	2	2	2	2	2	1	0	1	1	1
UK	0	0	0	0	0	4	5	5	5	5
Within-country comparability	68	68	72	64	56	48	60	72	80	80
Between-country comparability	120	130	94	74	92	77	46	60	60	110
Within-country index	0,850	0,850	0,900	0,800	0,700	0,600	0,750	0,900	1,000	1,000
Between-country index	0,400	0,433	0,313	0,247	0,307	0,257	0,153	0,200	0,200	0,367
Total comparability index	0,495	0,521	0,437	0,363	0,389	0,329	0,279	0,347	0,368	0,500

Table 7: The harmonization of the followed auditing standards

When it comes to the practice of conducting audits, it seems that the auditors have been rather unanimous on the method. (Table 8, Figure 12) As required by the ISAs, almost all companies have implemented some form of test basis into the evaluation of audit evidence. The implementation of the Eight Directive is clearly visible as an increase in the comparability within countries. However, due to the description of Finnish auditors performing audits according to professional judgment, the between comparability has decreased during the last two years of the examination period. Despite this phrasing, it can be assumed that the Finnish auditors implement a test basis, as it is too expensive and laborious to go through all audit evidence of an entity's processes.

How audit conducted	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Not specified	1	1	1	1	2	2	3	2	0	0
Finland	1	1	1	1	2	2	3	2	0	0
France	0	0	0	0	0	0	0	0	0	0
Germany	0	0	0	0	0	0	0	0	0	0
UK	0	0	0	0	0	0	0	0	0	0
WC Comparability	0	0	0	0	2	2	6	2	0	0
BC Comparabality	0	0	0	0	0	0	0	0	0	0
Test basis	19	19	19	19	18	18	17	17	15	15
Finland	4	4	4	4	3	3	2	2	0	0
France	5	5	5	5	5	5	5	5	5	5
Germany	5	5	5	5	5	5	5	5	5	5
UK	5	5	5	5	5	5	5	5	5	5
WC Comparability	72	72	72	72	66	66	62	62	60	60
BC Comparabality	270	270	270	270	240	240	210	210	150	150
Procedures acc. To auditor's judgment	0	0	0	0	0	0	0	1	5	5
Finland	0	0	0	0	0	0	0	1	5	5
France	0	0	0	0	0	0	0	0	0	0
Germany	0	0	0	0	0	0	0	0	0	0
UK	0	0	0	0	0	0	0	0	0	0
WC Comparability	0	0	0	0	0	0	0	0	20	20
BC Comparabality	0	0	0	0	0	0	0	0	0	0
Within-country comparability	72	72	72	72	68	68	68	64	80	80
Between-country comparability	270	270	270	270	240	240	210	210	150	150
Within-country index	0,900	0,900	0,900	0,900	0,850	0,850	0,850	0,800	1,000	1,000
Between-country index	0,900	0,900	0,900	0,900	0,800	0,800	0,700	0,700	0,500	0,500
Total comparability index	0,900	0,900	0,900	0,900	0,811	0,811	0,732	0,721	0,605	0,605

Table 8: Harmonization on the conduct of audit

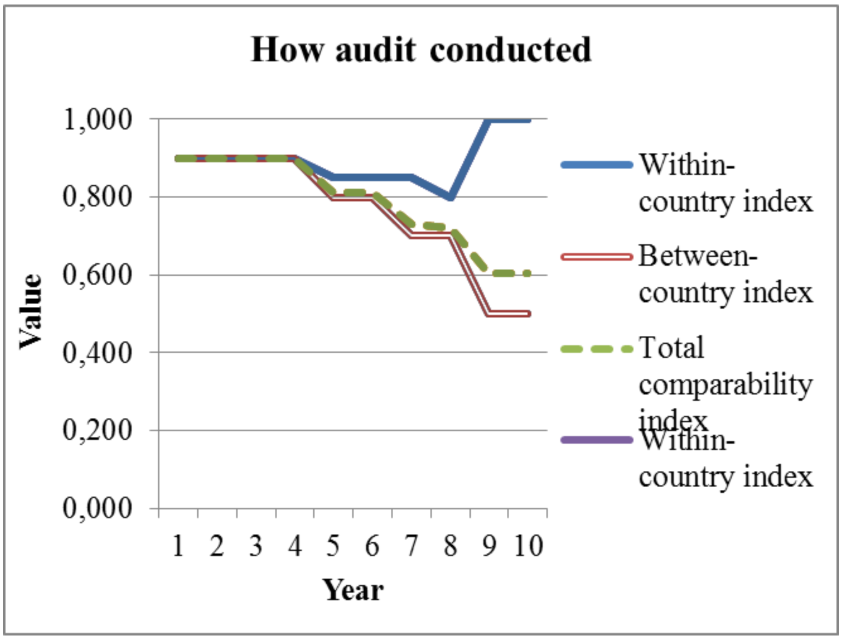

Figure 12: Harmonization on the conduct of audit.

Compared to the other elements of the audit reports, the audit opinion has been the most harmonized during the observation period. The French and German audit reports decreased the C-index during the first six years until transferring to the 'true and fair view' principle. However, 2008 was the first year that all companies followed the principle and thus the C-indices present full comparability on this element of the audit report.

Audit opinion	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
True and fair view	18	18	16	16	16	16	16	19	20	20
Finland	5	5	5	5	4	4	4	4	5	5
France	4	4	3	2	3	3	2	5	5	5
Germany	4	4	3	4	4	4	5	5	5	5
UK	5	5	5	5	5	5	5	5	5	5
Correct & sufficient information	0	0	0	0	1	1	1	1	0	0
Finland	0	0	0	0	1	1	1	1	0	0
France	0	0	0	0	0	0	0	0	0	0
Germany	0	0	0	0	0	0	0	0	0	0
UK	0	0	0	0	0	0	0	0	0	0
Present fairly, in all material respects	2	2	4	4	3	3	3	0	0	0
Finland	0	0	0	0	0	0	0	0	0	0
France	1	1	2	3	2	2	3	0	0	0
Germany	1	1	2	1	1	1	0	0	0	0
UK	0	0	0	0	0	0	0	0	0	0
Within-country comparability	64	64	56	60	52	52	60	72	80	80
Between-country comparability	244	244	196	192	194	194	186	270	300	300
Within-country index	0,800	0,800	0,700	0,750	0,650	0,650	0,750	0,900	1,000	1,000
Between-country index	0,813	0,813	0,653	0,640	0,647	0,647	0,620	0,900	1,000	1,000
Total comparability index	0,811	0,811	0,663	0,663	0,647	0,647	0,647	0,900	1,000	1,000

Table 9: The harmonization of the audit opinion

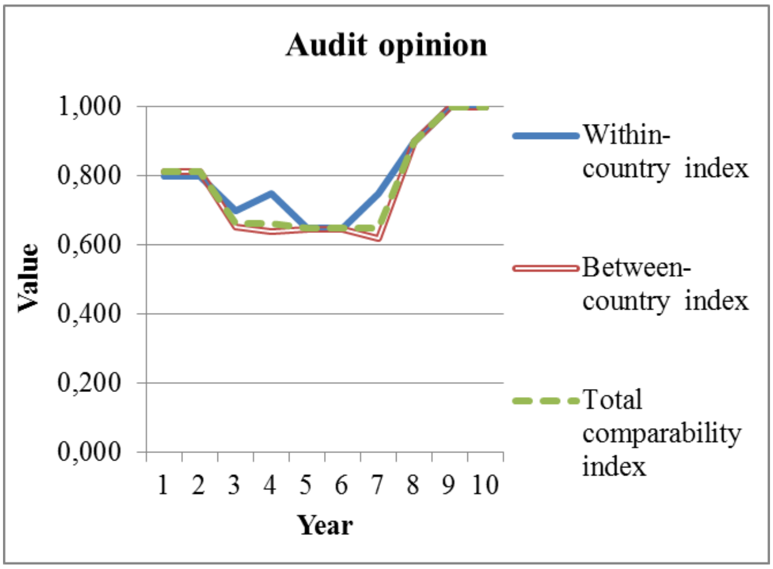

Figure 12: Harmonization of the audit opinion.

The harmonization of the audit reports will now be examined more carefully country by country. As seen, the audit reports have harmonized between the four countries, but more importantly nationally.

6.2 Finland

As can be seen in Table 10, the average length of the Finnish audit reports varies between 294 and 659 words, thus being longer than the French but shorter than the German and British reports. Overall, the Finnish reports are fairly similar to each other. The structure of the audit reports has remained more static than in other countries. Four out five companies began to report with headers from 2005 onwards. One company had separate headings already in 2003, as it transitioned to IFRS. There were two headers; the consolidated financial statements and the parent company's financial statements and administration. As the reports lengthened, the amount of headers also increased, as headers for responsibilities of the leading parties and the auditor were included. The word counts remained rather static until the application of the new IFRS regulations in 2005.

Prior to IFRS implementation, the audit reports explained the scope of the audit and responsibilities in a rather short manner as can be seen from the Konecranes audit report from 2003:

> *We have audited the accounting, the financial statements and administration of KCI Konecranes Plc for the financial period 1.1–31.12.2003. The financial statements, which have been prepared by the Board of Directors and the Managing Director, include the Report of the Board of Directors and the Income Statement, Balance Sheet and Notes. Based on our audit we express an opinion on the financial statements and administration of the parent company. (Konecranes, 2003)*

Disclosure of financial statements	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Financial statements not identified	0	0	0	1	2	5	4	3	0	0
Financial statements identified	5	5	5	4	3	0	1	2	5	5
C-index	1,000	1,000	1,000	0,600	0,400	1,000	0,600	0,400	1,000	1,000

Financial reporting framework	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not disclosed	5	5	5	4	3	0	0	0	0	0
US GAAP	0	0	0	0	0	0	0	0	0	0
Local GAAP	0	0	0	0	0	0	0	0	0	0
Local additional requirements	0	0	0	1	2	5	5	5	5	5
IAS	0	0	0	0	0	0	0	0	0	0
IFRS	0	0	0	1	2	5	5	5	5	5
C-index	1,000	1,000	1,000	0,600	0,400	1,000	1,000	1,000	1,000	1,000

Followed auditing standards	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
US GAAS	0	0	0	0	0	0	0	0	0	0
Local GAAS	5	5	5	5	4	4	4	4	0	0
National laws & Regulations	0	0	0	0	0	0	0	0	0	0
Good local audit practice	0	0	0	0	1	1	1	1	5	5
Standards of PCAOB	0	0	0	0	0	0	0	0	0	0
ISA	0	0	0	0	0	0	0	0	0	0
C-index	1,000	1,000	1,000	1,000	0,600	0,600	0,600	0,600	1,000	1,000

Audit method	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not specified	1	1	1	1	2	2	3	2	0	0
Test basis	4	4	4	4	3	3	2	2	0	0
Procedures acc. To auditor's judgment	0	0	0	0	0	0	0	1	5	5
C-index	0,600	0,600	0,600	0,600	0,400	0,400	0,400	0,200	1,000	1,000

Items assessed	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Significant estimates & judgments	4	4	4	4	3	3	2	2	5	5
Appropriateness of accounting policies	0	0	0	0	0	0	0	0	5	5
Content & manner of presentation of FS	5	5	5	5	4	5	4	5	5	5
Bookkeeping / Accounting principles	5	5	5	5	4	4	3	4	0	0
Risk	0	0	0	0	0	0	0	0	3	3
C-index	0,900	0,900	0,900	0,900	0,600	0,700	0,500	0,650	0,850	0,850

Audit opinion	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
True and fair view	5	5	5	5	4	4	4	4	5	5
Correct & sufficient information	0	0	0	0	1	1	1	1	0	0
Present fairly, in all material respects	0	0	0	0	0	0	0	0	0	0
C-index	1,000	1,000	1,000	1,000	0,600	0,600	0,600	0,600	1,000	1,000
AVERAGE WORD COUNT	295	294	295	306	319	395	446	466	626	659

Table 10: Comparability Index for Finland

The most distinctive features of the Finnish audit reports are therefore the inclusion of the parent company statements into the scope of the audit, the audit of the annual report, administration or corporate governance and accounting. Further, the auditors are also obliged to render an opinion whether the lead parties of the companies comply with the Companies Act and if they can be discharged from liability. The Auditing Act of 2007 dropped the requirement, but the majority of the companies still continued commenting on it in 2008 and 2009. The auditors are also expected to comment whether the Board of Directors' proposal regarding distributable funds is in compliance with required financial regulations and if the financial statements can be adopted. These features can be seen from the following final paragraph of the Huhtamäki 2000 audit report:

> *The financial statements, with the consolidated financial statements, can be adopted and the members of the Board of Directors and the Managing Director of the parent company can be discharged from liability for the period audited by us. The proposal by the Board of Directors regarding distribution of retained earnings is in compliance with the Companies' Act. (Huhtamäki, 2000)*

During the first three years, the structure of the Finnish audit reports remained similar. They began with an introduction explaining what was audited and who prepared the financial statements. Parent and the consolidated statements were audited simultaneously. All five companies were unanimous that it was the Board of Directors and the Managing Director / CEO's duty. The reports then continue to determine, which were the auditing standards that had been used to conduct the audit followed by an explanation of what was audited and how. The opinion part of the audit reports includes whether the statements give a true and fair view, if they comply with the financial reporting regulations, a discharge from liability and a comment on the proposal of remuneration made by the Board of Directors.

The structure of the audit reports remains the same throughout the ten years, but the elements of the audit reports are more thoroughly explained after 2003. It seems as though more thorough explanations are given in order to decrease the expectations gap discussed earlier. The three most important features lengthening the reports are the implementation of the IFRS regulations, the explanations of responsibilities as well as giving a separate opinion on the consolidated financial statements and the parent company statements. The responsibilities of the Board of Directors, the Managing Director and the President as well as the auditor are given their own paragraphs in post-IFRS audit reports. It seems that Finland has adopted the more detailed model for explaining respective responsibilities as used in the UK. The responsibilities of the Supervisory Board, Board of Directors, President and the CEO are explained in the following paragraph taken from Fortum's 2009 audit report:

> *The responsibility of the Supervisory Board is to supervise the company's administration by the Board of Directors and the President and CEO. The Board of Directors and the President and CEO are responsible for the preparation of the financial statements and the Operating and Financial Review and for the fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, as well as for the fair presentation of the parent company's financial statements and the Operating and Financial Review in accordance with laws and regulations governing the preparation of the financial statements and the Operating and Financial Review in Finland. The Board of Directors is responsible for the appropriate arrangement of the control of the company's accounts and finances, and the President and CEO shall see to it that the accounts of the company are in compliance with the law and that its financial affairs have been arranged in a reliable manner. (Fortum, 2009)*

The thorough explanations of responsibilities can be linked with the transparency requirements of corporate governance as well as an attempt to decrease the expectations gap. What is unusual in comparison to the other countries, Finnish audit reports have also audited administration and/or the corporate governance of the companies. These have been audited in separate audit reports in other countries if at all. Next, the harmonization of the audit reports will be evaluated through the six elements measured with the C-index.

A) Disclosure of financial statements

The identification of audited financial statements has varied throughout the years. During the years 2000-2002 and 2008-2009 all companies have identified the audited statements. In 2005, none of the companies identified the statements. In the new Auditing Act of 2007, this became mandatory for all audits. In addition to financial statements, the Finnish audit must also contain the audit of the annual report, bookkeeping and administration of an entity, as mentioned previously.

B) Financial reporting framework

The Finnish companies did not disclose their financial reporting framework until in 2003 in the first paragraph of the audit report as the other countries do. There was some dispersion in the frameworks in 2003 as Huhtamäki Oy transferred to IFRS reporting and in 2004, when Kone Oy joined. The other companies changed to IFRS in 2005, as required by law and thereafter the financial reporting framework was mentioned already in the beginning. From this perspective, the used frameworks have harmonized formally as the frameworks are legally binding. The C-index was at its lowest in 2004, as Huhtamäki and Kone had already started reporting according to IFRS, but the rest of the companies did not disclose their financial reporting framework.

C) Followed auditing standards

Considering the C-index in Table XX, the auditing framework is rather harmonized. All companies followed Finnish standards on auditing during the years 2000 and 2003. Atria's auditor switched to applying good auditing practice in 2004, whilst others followed in 2008. From 2000 to 2007, the auditors of Konecranes followed generally accepted auditing standards (which are considered as Finnish auditing standards) until transferring to good Finnish auditing practice along with the other auditors in this sample. The other companies followed Finnish standards on auditing in the years 2000 to 2007, but Atria changed to following good auditing practice in 2004. The requirement of good auditing practice is set in the Auditing Act 2007. In addition, it requires that the auditors comply with ethical requirements.

> *Good auditing practice requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements and the report of the Board of Directors are free from material misstatement and whether the members of the Board of Directors of the parent company and the Managing Director have complied with the Limited Liability Companies Act. (Kone, 2009)*

D) How audit conducted

During 2000-2005, the majority of companies reported to have audited according to a test basis.

> *An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. (Kone, 2000).*

In the years that Atria has not specified their method of conducting audit, they have simply explained what they have examined. Konecranes did not elaborate on the auditing method until 2008, when they too, transferred to auditing according to the auditor's judgment.

> *In our audit we have examined the bookkeeping and accounting principles, contents and presentation sufficiently enough in order to evaluate that the financial statements and the report of the Board of Directors are free of material misstatements or deficiencies. (Atria, 2006)*

It seems that the implementation of the Auditing Act of 2007 has replaced the usage of test-based audits with audit procedures based on obtaining evidence, the use of auditors' own judgment and internal control as demonstrated in Konecranes:

> *An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements and the report of the Board of Directors. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. (Konecranes, 2008)*

Atria was the first company to begin commenting on the sufficiency of audit evidence in 2005. Other companies followed in 2008, stating that either audit provides a reasonable basis for the opinion or that the audit evidence has been adequate. The C-index shows full comparability in the years 2008 and 2009, thus representing the harmonization effect of the Auditing Act 2007.

E) Items assessed

The only item that all audit reports reported to have audited every year was the legal compliance of the leading parties of the companies. It seems as though the Auditing Act 2007 has had a harmonizing effect, as all companies have reported having assessed the estimates of the directors, the appropriateness of accounting policies and the content and manner of presentation in 2008 and 2009. In addition, three companies reported to have analyzed risk, which has replaced the assessment of the accounting principles in 2008 and 2009.

F) Audit opinion

The most common type of audit opinion has been that the financial statements give a true and fair view. However, Atria's auditors reported that the financial statements present correct and sufficient information in 2004-2007. There seemed no clear reason for this, as the auditor had remained the same. Differing from other countries, the Finnish auditors have audited the parent company statements along with the consolidated statements and give an opinion on both statements as can be seen from Fortum's audit report:

> *The financial statements give a true and fair view, as defined in the Accounting Act of both the consolidated and the parent company's result of operations as well as of the financial position. (Fortum, 2002)*

All in all, it seems that the Finnish audit reports are rather similar and when changes have been implemented, they have been implemented to all companies at the same time. Further, based on this analysis one could say that the Finnish audit reports are rather harmonized and that the harmonization has increased throughout the years. As could be seen from the elements, the new Auditing Act of 2007 has had a strong harmonizing impact on the audit reports. There are no visible similarities or differences between the audit firms. It seems rather that the implementations of IFRS and the Auditing Act 2007 have had the strongest impact on the length and structure of the audit reports.

6.3 France

The French audit reports are relatively short in comparison to German and British reports, ranging from an average of 242 words to 359 words. In addition, the length of the reports varies yearly and unlike Finnish and German reports, it does not increase as the years go by as can be seen from Table 11. Further, word counts vary for each year in all five companies unlike any other country of the sample. What is different from other countries, some of the French auditors have audited also the financial statements of one or two previous years. Three companies reported having audited in addition two previous years in 2003-2004.

The structure of the French audit reports is fairly similar to that of the other countries. They begin with an introductory paragraph explaining the scope of the audit, responsibilities and used reporting frameworks. The next chapter explains the conduct of the audit and assesses the adequacy of obtained audit evidence. In the last part of the audit reports the auditors render an opinion on the financial statements. As discussed previously, French companies have to be audited by two auditors.

Although the Big 4 are dominant accounting firms in the audits of French-listed companies, domestic accounting firms are involved in the audits of French public companies alongside the Big 4. In fact, Francis et al. (2009) found in their study that the majority of French companies are audited by at least one non-Big 4 auditor. They also found that the agency theory is strongly supported as higher quality auditor pairs were more likely used in companies with less concentrated ownership, less ownership by families and greater levels of public and international ownership. However, they admit that it is yet unknown if the joint audit requirement is more effective and thus produces better quality audits than a single auditor approach.

Disclosure of financial statements	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Financial statements not identified	5	5	4	2	3	3	3	5	5	5
Financial statements identified	0	0	1	3	2	2	2	0	0	0
C-index	1,000	1,000	0,600	0,400	0,400	0,400	0,400	1,000	1,000	1,000

Financial reporting framework	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not disclosed	0	0	0	0	0	0	0	0	0	0
US GAAP	0	0	0	0	0	0	0	0	0	0
Local GAAP	5	5	5	5	5	0	0	0	0	0
Local additional requirements	0	0	0	0	0	0	0	0	0	0
IAS	0	0	0	0	0	0	0	0	0	0
IFRS	0	0	0	0	0	5	5	5	5	5
C-index	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000

Followed auditing standards	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
US GAAS	0	0	1	2	0	0	0	0	0	0
Local GAAS	2	3	0	0	1	1	0	0	0	0
National laws & Regulations	0	0	0	2	3	3	3	5	5	5
Good local audit practice	3	2	4	2	2	2	3	5	5	5
Standards of PCAOB	0	0	0	1	2	2	2	0	0	0
ISA	0	0	0	0	0	0	0	0	0	0
C-index	0,400	0,400	0,600	0,200	0,300	0,300	0,400	1,000	1,000	1,000

How audit conducted	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not specified	0	0	0	0	0	0	0	0	0	0
Test basis	5	5	5	5	5	5	5	5	5	5
Procedures acc. To auditor's judgment	0	0	0	0	0	0	0	0	0	0
C-index	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000

Items assessed	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Significant estimates & judgments	5	5	5	5	5	5	5	5	5	5
Appropriateness of accounting policies	2	2	2	2	2	2	2	2	3	4
Content & manner of presentation of FS	5	5	5	5	5	5	5	5	5	5
Bookkeeping / Accounting principles	3	3	3	3	3	3	3	3	2	1
Risk	0	0	0	0	0	0	0	0	0	0
C-index	0,700	0,700	0,700	0,700	0,700	0,700	0,700	0,700	0,700	0,850

Audit opinion	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
True and fair view	4	4	3	2	3	3	2	5	5	5
Correct & sufficient information	0	0	0	0	0	0	0	0	0	0
Present fairly, in all material respects	1	1	2	3	2	2	3	0	0	0
C-index	0,600	0,600	0,400	0,400	0,400	0,400	0,400	1,000	1,000	1,000
AVERAGE WORD COUNT	260	242	259	315	316	359	306	276	299	326

Table 11: Comparability Index for France

There was some dispersion in who prepared/approved the statements. In most cases it was the Board of Directors or the Group's Management. There was also a statement on their and the auditor's responsibilities as demonstrated in Schneider, 2000. However, the responsibilities were not discussed as thoroughly in other countries.

> *These financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit. (Schneider, 2000)*

From 2000 to 2007, all of the audit reports contained the following comment on the adequacy of audit evidence "We believe that our audit provides a reasonable basis for our opinion." (Nexans, 2004) In 2008, this sentence was replaced with "We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion." (Danone, 2008)

Moreover, French audit reports contain two further paragraphs after the actual audit opinion: the justification of assessments and specific verification. In the former paragraph, the auditors can draw attention towards matters they find important according to the requirements of article L. 225-235 of the French Commercial Code. From 2005 onwards, the justifications were made based on the requirements of article L. 823-9 of French Company Law (Code de commerce). Nexans and Schneider were the first to introduce this paragraph to their audit reports in 2003. From 2007, all five companies presented these justifications. Although these justifications have affected the qualification of the audit report, they have not been taken into account in the word counts or further analyzed in the study as they provide additional information to the audit reports.

> *The assessments we conducted were undertaken in connection with our audit processes of the consolidated financial statements, taken as a whole, and therefore contributed to the formation of our unqualified opinion as disclosed in the first part of this report. (Veolia, 2004)*

In the latter paragraph, the contents have varied, but the majority of the auditors have used it to render their opinion on the group management report, as demonstrated in the Danone audit report:

In accordance with professional standards applicable in France, we have also verified the information given in the group management report. We have no matters to report regarding its fair presentation and conformity with the consolidated financial statements. (Danone, 2007)

Other uses of the final paragraph include comments on how the use of US GAAP would have affected the report. Moreover, Lafarge used it to render an opinion on the effectiveness of the Group's internal control over financial reporting in 2005 and 2006.

A) Disclosure of financial statements

As can be seen from Table, XX none of the companies has not elaborated on the audited statements in the years 2000-2001 and 2007-2008. The scope of the audit has been solely the 'accompanying financial statements' in during these years. This trend is rather contrary in comparison to other countries, where the trend has been towards the elaboration of financial statements. The C-index is at its lowest in 2003-2006, at 0,400.

B) Financial reporting framework

The companies have been very unanimous in the use of financial reporting standards. All companies have used French GAAP when preparing their financial statements and then transferred to IFRS in 2005. Thus, the C-index shows full comparability for all years.

C) Followed auditing standards

During the first two years, the C-index demonstrates that there has been some harmonization in the choice of used auditing standards. The companies have chosen either the French generally accepted auditing standards as in Veolia's audit report, or the professional standards applicable in France, as in Nexans' report.

We conducted our audit in accordance with French generally accepted auditing standards (French GAAS). Those standards require that we plan and *perform the audit to obtain reasonable assurance that the consolidated financial statements are free of material misstatement. (Veolia, 2001)*

We conducted our audit in accordance with the professional standards applicable in France; those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. (Nexans, 2002)

Curiously, although Nexans did not change auditors, it changed the followed auditing standards each year until 2004. In 2000, they followed the French professional standards, in 2001 the French GAAS, in 2002 the US GAAS, in 2003 the standards of the PCAOB settling for French professional standards, which they have followed since 2004. These variations affected the C-index as the sample is rather small, and are visible on the changes in the years 2002 and 2003

The use of ISAs has not been very popular throughout the sample. None of the French auditors had prepared their audit accordingly. This could be explained through national professional standards, which take these international standards into account. Further, as discussed earlier, the justification of assessments introduced the use of national law into the auditing requirements. The auditing framework became harmonized in 2007 onwards, when all companies started conducting their audits according to professional standards applicable in France.

D) How audit conducted

The French audit reports were quite unanimous on how the audits were conducted. Until 2007, all companies reported to conduct their audits on a test basis, such as in the audit report from Nexans:

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. (Nexans, 2006)

However, in 2008, only two companies used the test basis and three companies relied on audit sampling and other testing methods. However, as they all consist of relying on assessing audit evidence on a more-or-less test basis, they have been included on the same row in the index. There is a nuance in the wordings of these explanations as demonstrated in the following extracts. The following wordings can be found in Lafarge and Schneider in 2008:

> *An audit includes verifying, by audit sampling and other selective testing methods, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used, the significant estimates made by management and the overall financial statements presentation.*

The following statement can be found in Danone, Nexans and Veolia in 2008 and in all companies in 2009, thus presenting full harmonization:

> *An audit involves performing procedures, using sampling techniques or other methods of selection, to obtain audit evidence about the amounts and disclosures in the financial statements.*

E) Items assessed

All of the companies assessed the significant estimates and judgments of the directors and the content and manner of the presentation of the financial statements each year. The C-index presents a slight increase in harmonization for 2009.

F) Audit opinion

There is a clearer separation between the use of true and fair view and the fair presentation of audit opinions than in the other countries. However, all five companies have used the true and fair view during the last three years, presenting harmonization towards the direction that other countries have used.

All in all, as in Finland, the year 2007 has been a turning point towards full harmonization in all audit report elements analyzed with the C-index. There were no clear differences in the audit reports between the audit firms.

6.4 Germany

The German audit reports are the second longest of the sample, varying on average from 379 to 466 words. (Table 12) The decrease in the average word count in 2002 is mainly due to BASF’s auditors following the US GAAS. Further comparing to other countries, the increase in the length of the audit reports is more restrained than in the other countries during the observation period. Although German reports did not have any sub-headers, their structure was still similar to the other examined countries’ reports. They begin with an introduction of what is audited; in addition to financial statements, the scope of the audit also includes a management report of some sort.

As in some French companies, the audit report of E.ON included the audit of the previous year during 2000-2004. The BASF 2002 included an audit of two previous periods. The first paragraph includes also a description of responsibilities as in the other countries. The level of detail of this description remains quite stable and does not increase as it does in e.g. the Finnish reports. The basic structure of this section can be seen from the BMW report:

> *The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit. (BMW, 2003)*

Disclosure of financial statements	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Financial statements not identified	2	1	2	2	2	1	1	1	1	1
Financial statements identified	3	4	3	3	3	4	4	4	4	4
C-index	0,400	0,600	0,400	0,400	0,400	0,600	0,600	0,600	0,600	0,600

Financial reporting framework	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not disclosed	2	1	2	2	2	1	1	1	1	0
US GAAP	1	1	1	1	1	1	1	1	0	0
Local GAAP	0	0	0	0	0	0	0	0	0	0
Local additional requirements	2	1	2	2	2	4	5	5	5	5
IAS	2	2	1	1	1	0	0	0	0	0
IFRS	0	1	1	1	1	3	3	3	4	5
C-index	0,200	0,100	0,150	0,150	0,150	0,300	0,400	0,400	0,600	1,000

Followed auditing standards	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
US GAAS	1	1	2	1	1	0	0	0	0	0
Local GAAS	5	5	5	5	5	5	5	5	5	5
National laws & Regulations	2	2	2	3	3	4	5	5	5	5
Good local audit practice	0	0	0	0	0	0	0	0	0	0
Standards of PCAOB	0	0	0	0	0	1	0	0	0	0
ISA	2	2	2	2	2	1	0	1	1	1
C-index	0,200	0,200	0,300	0,400	0,400	0,600	1,000	1,000	1,000	1,000

How audit conducted	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not specified	0	0	0	0	0	0	0	0	0	0
Test basis	5	5	5	5	5	5	5	5	5	5
Procedures acc. To auditor's judgment	0	0	0	0	0	0	0	0	0	0
C-index	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000

Items assessed	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Significant estimates & judgments	5	5	5	5	5	5	5	5	5	5
Appropriateness of accounting policies	1	1	0	1	1	0	1	1	1	1
Content & manner of presentation of FS	4	4	4	4	4	4	5	5	5	5
Bookkeeping / Accounting principles	5	5	5	5	5	5	5	5	5	5
Risk	0	3	3	2	2	1	1	1	1	1
C-index	0,900	0,800	0,800	0,700	0,700	0,600	0,800	0,800	0,800	0,800

Audit opinion	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
True and fair view	4	4	3	4	4	4	5	5	5	5
Correct & sufficient information	0	0	0	0	0	0	0	0	0	0
Present fairly, in all material respects	1	1	2	1	1	1	0	0	0	0
C-index	0,600	0,600	0,400	0,600	0,600	0,600	1,000	1,000	1,000	1,000

AVERAGE WORD COUNT	414	417	379	412	411	437	449	455	454	466

Table 12: Comparability Index for Germany

The second part of the audit reports contains the description of the performed audit. The definition of audit and how it is to be conducted is relatively long in the German audit reports. The chapter begins with an explanation what auditing standards have been followed and what they require from the conduct of the audit. Throughout the time span of ten years, this paragraph has remained very detailed and precise in all companies. This could be linked with the relatively high uncertainty avoidance of Germany.

> *According to these principles, the audit is to be planned and carried out in such a way that inaccuracies and violations are recognized with reasonable certainty that could have a major effect on the view of the net assets, financial position and results of operations conveyed by the Consolidated Financial Statements – taking into consideration generally accepted accounting principles – and Management's Analysis. (BASF, 2000)*

The last part of the audit report presents the audit opinion. As in other reports except the British, this chapter also contains an opinion on the management report and whether it provides a suitable understanding of the financial position and results in compliance with the financial reporting requirements. Additionally, the auditors gave an opinion of the management report's consistency with the financial statements. The British introduced these comments to their reports in 2005.

A) Disclosure of financial statements

The C-index remains quite static for the German audit reports, varying between 0,400 and 0,600. BASF has been consistent in not specifying the audited financial statements throughout the ten years. Otherwise, all the other companies have done so from 2005 onwards.

B) Financial reporting framework

BMW has not disclosed the used financial reporting framework until 2009. They have only commented what financial reporting standards they have used when conducting the management report. Compared to other countries in the sample, none of the companies has used the German GAAP as their financial framework. Rather, they have either used the international standards or the US GAAP. 2009 was the first year that all companies followed the IFRS, thus giving the C-index the value 1,00.

Beiersdorf reported according to IAS in 2000 and according to IFRS from 2001 onwards. Heidelberg followed the IAS during 2000-2004. BMW followed IAS in 2001. Further, E.ON followed US GAAP all the way until 2008, when they switched to IFRS. As the companies did not follow the German Commercial law, their audit reports had statements that they satisfied requirements to exempt from its use. The statement is exemplified in the following:

> *We furthermore confirm that, having regard to our foregoing statement, the Consolidated Financial Statements and the Group Management Report for the financial year ending December 31, 2001 satisfy the requirements for the Company's exemption from preparing Consolidated Financial Statements and a Group Management Report in accordance with German commercial law. On the basis of the interpretation of the 7th EC Directive by the European Commission Contact Committee on Accounting Directives, we have verified the compliance of the Group Accounts with the said Directive, which is a precondition for such exemption from the preparation of Consolidated Financial Statements under German Commercial Law. (Beiersdorf, 2001)*

C) Followed auditing standards

Unlike the Finnish and French auditors, the German auditors have followed the international standards on auditing per se. In most years, the auditors followed two or even three sets of auditing standards, one of them always being the German GAAS.

> *Pursuant to Section 317 of the German Commercial Code, we have audited the Consolidated Financial Statements of BASF Group in accordance with the generally accepted standard of auditing laid down by the German Institute of Auditors. (BASF, 2004)*

Heidelberg followed ISAs during 2000-2004 and Beiersdorf during 2000-2005.

> *We conducted our audit in accordance with German auditing regulations and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW, German Institute of Auditors), as well as in accordance with the International Standards on Auditing (ISA). (Heidelberg, 2001)*

In 2007, E.ON started using ISAs as an additional consideration in their audit reports.

> *We conducted our audit of the Consolidated Financial Statements in accordance with Article 317 HGB and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW), with additional consideration given to the International Standards on Auditing (ISA).*

D) How audit conducted

The conduct of the German audits has been explained in a rather complicated manner in the audit reports. All reports explain what the used auditing standards require as demonstrated in Heidelberg, 2000:

> *Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the Group financial statements in accordance with principles of proper accounting and in the Group management report are detected with reasonable assurance. (Heidelberg, 2000)*

In addition, all auditors used some sort of testing method as a basis for their audits, although the wording differed slightly:

> *The determination of the action for this audit takes into account knowledge of the business and BASF's economic and legal environment as well as expectations of possible errors. In the audit, the effectiveness of the internal*

checking system and proof of the details provided in the Consolidated Financial Statements and Management's Analysis are assessed predominantly on the basis of spot checks. (BASF, 2003)

The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. (Heidelberg, 2009)

Some German audit reports also contained a similar description of the audit as in the other countries:

Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. (E.ON, 2000)

E) Items assessed

All audit reports stated to have assessed the significant estimates and judgments of the directors every year, as other countries did. All companies also assessed the accounting principles each year. In most years, the majority of the companies also assessed the presentation of the financial statements and the management report. Unlike other countries, the German audit reports also contained the companies consolidated into the assessed items.

The audit also includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the Board of Management, as well as evaluating the overall presentation of the consolidated financial statements and Group Management Report. We believe that our audit provides a reasonable basis for our opinion. (BMW, 2009)

F) Audit opinion

Most German auditors rendered the opinion that the financial statements give a true and fair view. In addition, they also commented that the audit has not lead or given rise to any reservations. From 2006 onwards, all auditors have followed the true and fair view as their opinion. Since 2007, the C-index presents a high level of concentration within the six measured audit elements.

6.5 United Kingdom

The British audit reports are the longest of the sample, ranging from an average of 510 words (2000) to 823 words (2007). The development of the audit reports for United Kingdom is quite straightforward. The audit reports lengthened almost every year until they shortened due to a structural change in 2009 deriving from the application of the new Companies Act. This change was quite drastic, about 200-300 words in all five companies as can be seen from Table 13. As explained in the Appendix 4, the year 2009 was the first year when the 2006 Companies Act was applied in the audit reports. All in all, it seems like the audit reports are quite harmonized within the country, but not in comparison to other countries as hypothesized.

The British audit reports also follow a similar pattern of dividing their audit reports into three parts. They explain all the elements presented in the audit report more thoroughly than the audit reports in other countries of the sample.

Disclosure of financial statements	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Financial statements not identified	3	2	2	2	2	0	0	0	0	0
Financial statements identified	2	3	3	3	3	5	5	5	5	5
C-index	0,400	0,400	0,400	0,400	0,400	1,000	1,000	1,000	1,000	1,000

Financial reporting framework	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not disclosed	0	0	0	0	0	0	0	0	0	0
US GAAP	0	0	0	0	0	0	0	0	0	0
Local GAAP	5	5	5	5	5	0	0	0	0	0
Local additional requirements	0	0	0	0	0	5	5	5	5	5
IAS	0	0	0	0	0	0	0	0	0	0
IFRS	0	0	0	0	0	5	5	5	5	5
C-Index	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000

Followed auditing standards	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
US GAAS	0	0	0	0	0	0	0	0	0	0
Local GAAS	0	0	0	0	0	0	0	0	0	0
National laws & Regulations	0	0	0	0	0	4	5	5	5	5
Good local audit practice	5	5	5	5	5	1	0	0	0	5
Standards of PCAOB	0	0	0	0	0	0	0	0	0	0
ISA	0	0	0	0	0	4	5	5	5	5
C-Index	1,000	1,000	1,000	1,000	1,000	0,600	1,000	1,000	1,000	2,000

How audit conducted	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Not specified	0	0	0	0	0	0	0	0	0	0
Test basis	5	5	5	5	5	5	5	5	5	5
Procedures acc. To auditor's judgment	0	0	0	0	0	0	0	0	0	0
C-index	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000

Items assessed	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Significant estimates & judgments by direct	5	5	5	5	5	5	5	5	5	5
Appropriateness of accounting policies, cor	5	5	5	5	5	5	5	5	5	5
Content & manner of presentation of FS	5	5	5	5	4	4	4	4	4	5
Bookkeeping / Accounting principles	0	0	0	0	0	0	0	0	0	0
Risk	0	0	0	0	0	0	0	0	0	0
C-index	1,000	1,000	1,000	1,000	0,900	0,900	0,900	0,900	0,900	1,000

Audit opinion	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
True and fair view	5	5	5	5	5	5	5	5	5	5
Correct & sufficient information	0	0	0	0	0	0	0	0	0	0
Present fairly, in all material respects	0	0	0	0	0	0	0	0	0	0
C-index	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000

AVERAGE WORD COUNT	510	528	706	687	688	754	777	823	815	573

Table 13: Comparability Index for the United Kingdom.

What is distinctive for the British reports is that have they two sections that the others do not. They explain that their reporting duty is solely towards the company's members. In the other countries, the reports may have had a comment 'to the shareholders' before the first introduction. This more detailed description was used each year in Centrica, during 2002-2009 in AstraZeneca, Johnson Matthey and SABMiller and from 2005 onwards in Smith Nephew. Before this, the companies followed the method of other countries.

> *"This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985 and, in respect of the separate opinion in relation to International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB), on terms that have been agreed with the Company. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and, in respect of the separate opinion in relation to IFRSs as issued by the IASB, those matters that we have agreed to state to them in our report, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed." (AstraZeneca, 2007)*

The other distinctive section can be found in the second part of the audit report. In addition to explaining that the scope of the audit is to render an opinion based on the audit as in other countries, all of the British auditors of the sample explained in detail what matters would cause them to report on additional matters.

> *We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts and the part of the remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the accounts, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if the information specified by law or the Listing*

Rules regarding directors' remuneration and transactions with the Group is not disclosed. (Centrica, 2003)

Normally, issues of this proportion could result in the possible qualification of the audit report. This as well can be interpreted as a precaution to decrease the expectations gap and to increase the communicative value and credibility of the audit report as well as increasing the reader's knowledge of what the purpose of the audit is.

Further, the audit includes a review of the corporate governance statement and its compliance with the Combined Code. The Combined Code consists of two parts: 1) principles of good governance, based on transparency and openness in disclosure practice, and 2) best practice. It is based on the recommendations of Cadbury and Greenbury and compliance is mandatory for all listed companies. (KPMG III, p. 2682) In the audit reports the review and what it includes is clearly elaborated as seen in Johnson Matthey:

We review whether the statement on pages 25 and 26 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures. (Johnson Matthey, 2002)

Apart from these two sections, the structure of the audit reports resembles that of the other countries. They too contain three parts, the introduction, the scope and the opinion. The audit reports were unanimous in when it came to who prepared the financial statements. It was the responsibility of the managers and these responsibilities had been stated more clearly in the statement of directors' responsibilities published simultaneously with the audit report. The responsibilities of the auditors were also clearly stated in all reports as demonstrated in Smith & Nephew:

The directors are responsible for preparing the annual report. As described on this page, this includes responsibility for preparing the accounts in accordance with applicable United Kingdom law and accounting standards.

> *Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority and by our profession's ethical guidance. (Smith & Nephew, 2000)*

From 2005 onwards, the auditors started to comment that they had prepared a separate audit and thus audit report on the parent company in all companies except in Johnson Matthey, where the auditors rendered the opinion for both the consolidated and parent company statements on the same report.

A) Disclosure of financial statements

AstraZeneca and Johnson Matthey, both audited by KPMG, did not specify the audited financial statements until the year 2005 onwards. Between the years 2002-2004 all of the audit reports included the "auditable part" of the management report into their scope of audit. This auditable part contains the disclosures required by "Part 3 of Schedule 7A to the Companies Act 1985 contained in the directors' remuneration report ('the auditable part')" (Centrica, 2002). From 2005 onwards, all companies have identified the financial statements included into the audits. Further, it became mandatory along with the introduction of the Companies Act 2006.

B) Financial reporting framework

The financial reporting framework is rather unanimous in the five companies. Before 2005, they have reported to use applicable UK law and standards in the preparation of their annual statements. In 2005, they all switched to IFRS reporting although still following applicable law in addition. One of the companies reported additional information under US requirements between the years 2000-2005.

C) Followed auditing standards

The used auditing standards have been the same for all companies each year except for 2005, as SABMiller did not transfer to the use of ISAs as the other companies did. Despite this, the auditing framework depicts high concentration of auditing standards. In 2009, all companies followed

> *Our responsibility is to audit the financial statements and the auditable part of the directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. (SABMiller, 2005)*

> *Our responsibility is to audit the accounts and the part of the directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). (Johnson Matthey, 2008)*

D) How audit conducted

As described earlier, the British audit reports elaborate on the conduct and its scope more than those of audit reports. All companies used some sort of test basis, which is the most common auditing method in the other countries. The conduct of audit presents a high level of concentration.

> *We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group Financial Statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the Group Financial Statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed. (AstraZeneca, 2008)*

> *We planned and performed our audit so as to obtain all the information and explanations, which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Financial Statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error.*

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Financial Statements and the part of the Directors' Remuneration Report to be audited. (AstraZeneca, 2004)

As the other countries, the British audit reports also contained a comment on the adequacy of the audit evidence.

E) Items assessed

All companies have assessed the significant estimates and judgments made by the directors as well as the appropriateness of the accounting policies. Moreover, four out of five companies have also included the assessment of the content and presentation of the financial statements.

F) Audit opinion

All companies rendered an opinion according to the 'true and fair view' principle, thus presenting full harmonization on this matter each year. One of the companies gave a separate audit opinion according to US GAAP from 2003 onwards.

7 CONCLUSIONS

This study has discussed the role of auditing and audit reporting in a national and international environment. The first part of the paper laid down the theoretical frame, depicting the importance of an audit for the functioning of corporate governance as well as functioning as a communicative tool for auditors. However, the requirements and purposes for an audit vary between countries. This is a consequence and reflection of strong national dynamics that have affected the whole of accounting, reporting preferences as well as auditing.

Culture plays an important role on the reporting traditions of a country. It is reflected in the auditing institutions as a country's legal traditions. Legal traditions of a country affect how regulations are set and promulgated. La Porta et al. (1998) divided the countries into two major families based on their legal traditions. Finland, France and Germany belong to the civil law tradition and the United Kingdom to the civil law tradition. The common law tradition "uses statutes and comprehensive codes as primary means of ordering legal material, and relies heavily on legal scholars to ascertain and formulate its rules" (La Porta et al., 1998). This can also be seen in the national audit legislation, which for all countries is rather detailed. Further, as noted by Hofstede (1982), these countries have a relatively high uncertainty avoidance degree. Gray (1988) further notes that uncertainty avoidance can be closely linked with uniformity and individualism which are reflected on the regulations of the auditors.

The national auditing standards are legally binding for the statutory auditors. The position of auditing professional is seen as traditional, i.e. concerned with the implementation of prescriptive and detailed legal requirements. In terms of Gray (1988) it could be said that for these three countries, the profession relies on statutory control. Further, all three countries have two auditing bodies. Finland, France and Germany have also traditionally had highly concentrated corporate ownership. This has led to increased expenses of capital and other corporate governance issues in the countries. Due to this, the purpose of the statutory auditor not as much monitoring but rather fulfilling a statutory reporting purpose.

On the other hand, as the United Kingdom belongs to the civil law family, it has different traditions for legislation. The standards issued by the local APB are conceived as good auditing practice, however not legally binding. The position of auditors is not traditional as in the three other countries, but highly dependent on the auditor's judgment as an independent professional and in Gray's (1988) terms relies on high professionalism. United Kingdom has effective capital markets and a dispersed ownership. As opposed to the other countries, the British statutory auditor has an important monitoring role and works to decrease information asymmetries.

It seems that irrespective of the promulgation of auditing standards or the standard setter, the audit reports are in unison within countries. It seems that the legal requirements along with the professional standards have resulted in a well-regulated profession. However, due to international standards on auditing (ISAs) and other requirements governing the good conduct of audit, audit reports have moved towards each other in their structure and wording. Thus, it can be said that hypothesis 1 holds true. (*H1: Audit reports vary internationally more so than nationally.*)

Further, as Finland, France and Germany have similarities in their national dynamics and standard setting, their audit reports were more alike than those from the UK. It could be seen from the audit reports that the division between civil law and common law families hold true. Due to cultural and legal traditions, the second hypothesis holds true. *(H2: The audit reports of Finnish, French and German companies have similar features but differ from those of the British companies.)*

As noted from the empirical results, the level of detail increased in the audit reports. This can be linked to the attempts to decrease the expectations gap as well as to increase the overall transparency of corporate control. The reports pursued to explain the audit process and the respective responsibilities in high detail and thus, the third hypothesis holds true. (*H3: The audit reports have increasingly detailed descriptions of responsibilities and the audit process itself.)*

Based on the analysis, it seems that the framework conducted previously still holds true. National dynamics have had a strong effect on the national audit reports. Especially important have been the efficiency of shareholder markets and the main purpose of the audit. However, it seems that their effect is decreasing as the auditing sphere is globalizing. Despite the small sample size, the results present trends in the development and harmonization of the audit report. Based on the analysis provided, it seems that the trend is towards more harmonized audit reports as the C-index has presented increases in most of the six elements. It seems that the mandatory implementation of the IFRS standards and the introduction of the EC Directive 2006/43/EC have had a strong harmonizing effect nationally and internationally. The comparability indices presented a notable increase in harmonization for the years from 2007 onwards, thus the fourth and final hypothesis can be claimed true. (*H4: The Eight Directive has had a harmonizing effect on the audit reports.)*

The obtained results show that harmonization of regulations is reflected in the audit practices as well. As Aisbitt (2001) noticed in her article, increases in harmony were not restricted to periods where harmonizing legislation had been applied. Thus, she concludes that it is not possible to claim that changes in legislation have contributed to or hindered harmonization on a general level. Therefore, she notes that it is compulsory to examine carefully items that may have affected practice in the context of factors apart from legislation. Aisbitt (2001) sidestepped this issue by analyzing items in three settings: 1) Areas where there seems to be some evidence that legislation contributed to harmonization, 2) Areas where harmonization seems to have occurred independently of legislation, and 3) Areas where harmonization has decreased in spite of legislation.

All in all, it seems that audit reporting practices are harmonizing. However, it would require a larger sample with more countries and companies in order to determine what the level of harmonization is. Further studies should also include companies of different sizes. An interesting aspect is also the harmonization effect of the Big Four countries, which should be further researched. It is yet to be seen, whether the International Standard on Auditing will be obtained as official international auditing standards, or will there be another set of standards that will gain more popularity.

It remains to be seen, how far and into what direction the harmonization initiatives will be taken. Interestingly, the EU has recently suggested that the more countries should apply the French model of requiring two auditors for public companies. This could be perceived as an attempt towards more efficient and transparent audits. However, in the meantime it would bring more costs to the companies.

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APPENDIX

Appendix 1: Main features of Finnish auditing regulations

The legal framework for auditing and auditors in Finland is laid out in the Auditing Act, Auditing Ordinance, and the Ministerial Decrees. Detailed provisions on the enforcement of the Auditing Act are laid out in the Auditing Ordinance, which came into force simultaneously with the Act. The Act contains provisions for the statutory audit, the qualification requirements for auditors, authorization, and supervision of auditors. According to the Act, all registered companies, foundations and other legal entities must appoint an auditor to audit their annual and consolidated statements. Further, as laid down in the Auditing and Companies Acts, companies (subject to small company exemptions) must comply with the KHT audit rules. The Ordinance contains more detailed regulated procedures in oversight bodies. The Ministerial Decrees consist of detailed requirements of authorization. The Chamber of Commerce Act contains the basic guidelines of organizations and objectives of the Chamber of Commerce.

The Institute of HTM auditors (The Registered Association of Certified HTM-Auditors, HTM-tilintarkastajat Ry) does not issue auditing standards and thus the same standards, principles and rules of ethics as well as guidelines of good auditing practices apply to the activities of HTM auditors and HTM audit firms. The HTM institute functions as an educational and lobbying organization for its members. Its main purpose is to ensure the maintenance of its members' proficiency and the enhancement of their professional benefits. Both KHT and HTM are listed as members of the IFAC.

The Central Chamber of Commerce (CCC) authorizes the KHT auditors and the regional chamber of commerce authorizes the HTM auditors. The membership in both bodies is however, voluntary. The size and foundation of a company determine whether the company must appoint either a KHT or HTM auditor. Smallest companies can appoint a so-called layman auditor. (KHT, accessed on 30.3.2011) Due to their size, all Finnish companies in the sample have been audited by KHT auditors.

The Auditing Board of the Central Chamber of Commerce (CCC) performs the regulatory oversight of the accountancy profession. It ensures compliance with the Auditing Act and other professional requirements by the KHT auditors and supervises the regional chambers of commerce regulating the HTM auditors. In addition, the Ministry of Employment and Economy, although not directly overseeing the auditors and audit firms, has the responsibility for defining legislation and regulations in the areas of accounting and auditing. The Ministry also assigns the members and defines budgets of oversight bodies, and licenses chambers of commerce. (CCC, 2009)

During the time frame of 2000-2009, two Auditing Acts have applied in Finland. The first one was set in 1994 (936/1994) and the second in 2007 (459/2007). The new Auditing Act, which came into force in July 2007, complies with the EC Directive No. 2006/43/EC. The directive requires that all statutory audits of annual and consolidated accounts are to be carried out in accordance with international auditing standards as adopted by the European Commission (EC). An auditor must give out an audit report on each accounting period. The report must be assigned to the board or equivalent governing body of the entity not later than two weeks before the meeting in which the financial statements are presented for adoption. According to the Auditing Act of 1994, the report must include a statement of the following:

1) Financial statements' compliance with the Accounting Act and other rules and regulations governing the preparation of financial statements;
2) Do the financial statements give correct and sufficient information on the results of operations and the financial position of the entity;
3) Adoption of financial statements;
4) The treatment of earnings according to the board or equivalent governing body;
5) Discharge from liability.

In addition, the auditor must make a comment in their report if a partner, a member of the board, committee or equivalent governing body, president, vice president or managing director or any other accountable of the entity is guilty of delinquency or any other act leading to liability for damages or to any other action conflicting with the articles of association or regulations. Further, the auditor must improve the information in the financial statements when necessary. The auditor may give out additional information regarding the financial statements or any other information in the auditor's report if considered necessary. In addition, a specific report on the group must be given. (936/1994)

The time and assignment requirements for the auditor's report have remained the same in the Act of 2007. However, the newer Act requires that the auditor must give out a signed and dated report each accounting period. In addition, the report must individualize the financial statement at hand and explain, which accounting standards have been followed in preparation thereof. The auditor's report must also inform of the use of international auditing standards. Other requirements concerning the audit report are the same as in the previous Act except for the statements. The report must contain a statement on the following:

1) Do the financial statements and annual report give correct and sufficient information on the results of operations and the financial position of the entity in compliance with the used accounting standards;
2) Is the information in the annual report and financial statements free of conflict

As Finland transferred to Euro in 2001, the Auditing Act 1994 had to be changed accordingly. The Finnish Parliament accepted changes to the conditions for appointing an auditor in December 2001. The original mark sums from 1994 will be shown in brackets. These conditions remained the same in the Act of 2007. If an entity is a publicly traded company or 2 of the following 3 conditions are met, the partners, shareholders' meeting or equivalent governing body must appoint at least one KHT auditor or KHT firm:

1) The balance sheet total exceeds 25 000 000 Euros (150 000 000 marks)
2) Net sales or comparable revenue exceeds 50 000 000 Euros (300 000 000 marks)
3) The average number of employees exceeds 300 people

According to both Acts, the parent company of the group must be audited if the above conditions apply. In addition, an auditor must be appointed a replacement if the auditor is a natural person. If the auditor is an auditor firm, a principal auditor must be appointed. Both Acts also have regulations relating to the independence of the auditor. According to both Acts the auditor must refuse to accept or give up the engagement if preconditions for independence are missing. There are also regulations for the disqualification of the auditor. The Act of 2007 is stricter if both senses.

According to the Finnish regulations, an auditor must be a natural person or an accepted auditing group. The auditor must hold such knowledge of accounting, business and legal matters as well as knowledge and experience of auditing, which can be required based on the quality and extent of the entity's actions to be able to take care of his/her duties. Only a person who is not under guardianship, who is not in bankruptcy, who has not been barred from conducting business, and whose legal capacity has not been restricted can act as an auditor. In addition, if one or several natural persons are appointed, at least one of them has to be a resident in an EEA state. The first requirement has been removed in the 2007 Act.

Appendix 2: Main features of French auditing regulations

Two laws have had the maximum impact on the auditing profession in France. These were the 2003 Financial Security Law, which led to the creation of the High Council in France of Statutory Auditors (Haut Conseil du Commissariat aux Comptes, HCCC) and the Law on the Modernization of the Economy of 2008, leading to the adaption of statutory audits for small and medium sized entities (SMEs). The 2003 Financial Security Law also strengthened the joint audit requirement as well as established the French Financial Market Authority (Autorité des Marchés Financiers, AMF). The AMF must be informed of proposals to appoint or reappoint auditors of listed companies. It can also request information on listed companies from auditors and it is entitled to inspect an auditor of a listed company. The AMF can also request assistance from the CNCC.

Although not having a specific role in the standard setting of accounting and auditing, the Financial Markets Authority (AMF) is entitled to publish guidance on a broad range of financial reporting requirements. Further, it is allowed to provide advice on the appointment of statutory auditors with regard to listed companies. AMF is empowered by the Monetary and Financial Code to regulate the securities market. (eStandardsForum, accessed on 03.10.2010)

Further, the French Financial Security Law (2003) created a new internal control-reporting requirement for the auditor. According to this requirement, auditors must render an opinion on the chairman of the Board of Directors' report describing the internal control procedures relating to the origination and processing of the accounting and financial information. The auditors are also required to elicit issues along with the AMF client that are likely to impact financial reporting, under a waiver of client confidentiality. The auditors must inform the AMF on cases where auditors refuse to certify the statements, on cases of going concern issues or when irregularities or inaccuracies arise. (Financial Security Law, 2003)

According to French regulation, an auditor must certify that the financial statements give ‘a true and fair view of the company’s result for the year and of the state of affairs at the year end’ (Article 228, Commercial Code). The statutory auditor is also required to report on compliance with company law, criminal acts or fraud that have a material impact on the financial statements, and going concern. The audit must be conducted in accordance with the generally accepted auditing standards and guidelines promulgated by the CNCC. Moreover, France has adopted a proportional liability system, which places liability upon the defendants according to their contributions to damages (Buijink et al., 1996 in Francis et al., 2009). France has also a number of regulations to ensure auditor independence in addition to the joint auditor requirement.

The HCCC and the CNCC are in charge of monitoring the professional conduct and the independence of the statutory auditor. In addition, the HCCC also gives advice on professional standards, addresses appeals regarding disciplinary sanctions and supervises the external quality assurance system. Further, it benchmarks and promotes the best practices, hears appeals regarding disciplinary sanctions. (Baker et al. 2001; eStandardsForum, 03.10.2010) The CRCC and CNCC were established by the 1969 Government Decree. The CNCC cooperates with the Order of Chartered Accountants (l’Ordre des Experts-Comptables, OEC) on issues of common professional interest.

The CNCC translated the pre-clarified ISAs with modifications to account for local legal and regulatory requirements in 2000. These translated international standards were incorporated into the national auditing standards, Standards of Professional Practice or NEP. Thus “the profession’s standards were granted the status and authority of ministerial decree, while still maintaining compliance with international audit standards”. The Ministry of Justice also endorsed a second set of auditing standards, including the basic principles and essential procedures of the pre-Clarified, and in some cases Clarified, ISAs. (eStandardsForum, accessed on 03.10.2010) In 2009, France had fully transposed the EU Directive 2006/43/EC into its national legislation. However, the convergence with ISAs is still ongoing in France and the national auditing standard-setter adopts IAASB's pronouncements with modifications so as to provide for local legal and regulatory requirements. It is also stated that the National Organization of Auditors (Compagnie Nationale des Commissaires aux Comptes, CNCC) supports the EU in the adoption process of ISA and, as of December 2009, it was translating Clarified ISAs for future use in the Member States. (eStandardsForum, 02.10.2010) . King (1999) claims that the French auditing standards are equivalent 'in all material respect' to ISAs.

Appendix 3: Main features of German auditing regulations

The German auditing framework comprises of legislation and auditing standards. The German Commercial Code (HGB) forms the basis for the auditing standards as it contains general requirements for financial-statement audits for listed and unlisted companies. The Institute of Public Auditors in Germany (Institut der Wirtschaftsprüfer in Deustschland e.V., IDW) issues German auditing standards (AuSs) based on ISAs as issued by the IAASB. The pronouncements of the IAASB are adopted as AuSs but modified by the IDW to incorporate local legal requirements.

WPO, the Law Regulating the Audit Professions contains provisions governing authorized auditors. The WPO specifies the manner in which a person can become a statutory auditor and defines inter alia: the admission requirements for the auditor's examination, the rights and duties of the auditor, the organization of the WPK, the disciplinary measures for breaches of professional duties, and the organization and rules of procedure of the Chambers and Senates for statutory auditor matters in the German courts.

Under the Accounting Enforcement Act (BilKoG), a two-tier enforcement system has been put in place in Germany according to a 2006 United Nations Conference on Trade and Development (UNCTAD) report. The first tier is formed by the German Financial Reporting Enforcement Panel (FREP). It monitors infringements and ensures compliance with the accounting requirements by examining consolidated and separate financial statements of listed German entities. However, it has no authority to impose sanctions. The second tier is formed by the Financial Supervisory Authority (BaFin). It functions as an integrated financial supervisory authority for the banking, securities and insurance sector. As a federal agency, it is called upon by the FREP when further action is needed. It also has the legal to impose sanctions in cases of violations.

Germany has been working towards harmonization of the national auditing standards with international standards since the late 1990s. In addition, as Germany is a member of the Federation des Experts Comptables Europeens (FEE), which represents the European auditing profession, the country takes actively part in the harmonization of auditing standards in Europe. Thus, IDW followed closely the development and issuance of the EU Audit Directive No. 2006/43/EC. As other member states, Germany is in the process of enacting its auditing standards in line with the Clarified ISAs issued by the IAASB in 2009.

In general, German law is very detailed. As a consequence of the statute law system, financial accounting and reporting standards are set by the legislature. Principles of proper bookkeeping (GoB) are used as a basis in the regulation of all future events (even the unforeseeable ones). These principles apply irrespective of e.g. the legal form or size of an enterprise. Most of these principles are codified in the Commercial Code, unlike in many other countries. Thus, to the extent that law is unambiguous, there is no need for organizations that develop or propose principles of proper bookkeeping. However, where ambiguities do appear, the principles are improved through deductive reasoning, in which scientific communities and practitioners' organizations take part. Usually, it is the Institute of Certified Public Accountants (Institut der Wirtschaftsprüfer in Deutschland, IDW) that resolves the problems through interpretation of the principles of proper bookkeeping (Grunsätze ordnungsmäßiger Buchführung, GoB). According to the authoritativeness principles, the principles of proper bookkeeping in commercial accounting are binding also upon tax accounting where specific tax rules do not exist.

Financial accounting and reporting are subject to detailed regulation under the German legal system. The framework of law is twofold; there are general principles that bind all forms of business organizations, and principles that relate specifically to legal form, size, industry sector and stock exchange listing. The former rules are defined in the First Section of the Third Book of the Commercial Code (Handelsgesetzbuch, HGB), and the latter are defined in specific sections of the Code or specific Acts respective of the business form. (eStandardsForum, 23.10.2010)

Auditing requirements are primarily contained in the German Commercial Code and non-binding auditing standards issued by the Institute of Auditors (IDW). Both listed and unlisted companies must apply these requirements, although the latter is subject to certain size criteria. The IDW issues the German auditing standards (AuSs) and they are based on the ISAs. ISAs are adopted in the German Auditing Standards (AuSs), although changes have been made to reflect the local legal and regulatory environment. German standards are based on a "line-by-line" analysis of ISAs and the differences between AuSs and ISAs are not clearly indicated in the text of the standards. However, according to a 2009 IDW Action Plan, Germany is in the process of enhancing its auditing standards in line with the Clarified ISAs issued by the IAASB in 2009. German auditing requirents are further specified in the HGB and are supplemented by a number of other laws, such as the German Limited Liabilities Company Act (GmbHG), German Stock Corporation Act (AktG), German Law on Limited Liability Partnerships (PartGG) and German Publicity Law (PublG).
(eStandardsForum, accessed on 26.10.2010)

As is the case in the other comparison countries, shareholders appoint the auditors. They can be either chartered accountants (Wirtschaftprüfer, WP) or audit firms (Wirtschaftsprüfungsgesellschaften, WPG). After the investigations, the auditor must report the results in writing. The first part of the audit report (Prüfungsbericht), focuses on future development and the viability of the going concern. It consists of the auditor's comments on management's judgment of the company's situations as stated in the management report. In the main part, of the audit report it must be stated whether the audit evidence complies with the legal requirements and company statutes and whether the legal representatives have provided the required information and explanations. Items included in the financial statements must be analyzed, specified and commented upon. The auditor must also comment on the true and fair view of the annual statements and their compliance with the principles of proper bookkeeping. The object, scope and method of the audit must be clearly defined and explained separately.

The audit reports, varying in length and content, are then sent to the management and the supervisory board. However, shareholders' meetings or individual shareholders are not allowed to receive the audit report. Thus, they must settle for the information contained in the audit opinion (Bestätigungsvermerk). The audit opinion has to include a description of the object, scope and method and a summary of the audit results. Also the opinion of the audit has to be stated, i.e. whether or not does the annual statements provide a true and fair view in accordance with the principles of proper bookkeeping. The audit opinion has to be written in such a way that it is comprehensible to the great public. This requirement came into force with the amendments of the Commercial Code in 1998.

According to HGB § 267, the balance sheet, the profit and loss statement, the notes and the management report of a corporation must be audited if it is at least of medium size. A company is perceived large, if its shares or other securities are 1) officially traded on the Stock Exchange (amtlicher Handel), 2) admitted to the organized to the stock market (geregelter Markt) or 3) dealt in over-the-counter on a stock exchange in a member country of the European Community, or where permission to trade has been granted for. Interim reports of listed stock corporations need not be audited. According to HGB § 317, the audit of financial statements must be of sufficient scope to expose errors or offences against the legal regulations and the additional provisions if they affect notably a fair presentation. (KPMG, p. 1335) According to HGB § 292, companies, which are both parent companies and listed on a stock exchange are not obliged to present commercial code group statements if they are published according to 'internationally accepted accounting standards'. The information quality of these standards was required to be equivalent to commercial code group standards and in compliance with the Seventh EU Directive. (KPMG II, 1233)

The Auditor Oversight Board (AOB) performs professional oversight. It was established following the Auditor Oversight Act passed by the German parliament in December 2004. The AOB is responsible for disciplinary investigations and quality assurance. (eStandardsforum, accessed on 23.10.2010) Unlike other countries of the sample, German companies have two-tiered boards comprised of board of management and the supervisory.

Appendix 4: Main features of British auditing regulations

Two Companies Acts have applied during 2000-2009, namely the 1985 Companies Act, which was partially amended in 1989, and the Companies Act 2006. The implementation of the new Companies Act 2006 was set out to take place in parts. The final stage of the implementation was reached on October 2009. The implementation of parts 15 concerning statements and part 16, concerning audit was applicable for accounting periods starting on or after April 6, 2008 and thus all companies of the study sample have applied it during the final year of the studied time frame. The main purpose of these parts is to complete the implementation of the EU Company Reporting Directive (Directive 2006/46), which will be discussed in more detail later in the paper. The new UK Companies Act of 2006 has "placed more emphasis on greater stakeholder accountability by companies" (Solomon, 2010). The most notable differences between the two Acts concern auditor's liability. According to the newer Act, the auditors are now permitted to limit their liability for claims in negligence, breach of trust or breach of duty as long as certain criteria apply.

According to 1985 Act, an auditor must carry out such investigations in preparation of the audit report to be able to form an opinion on 1) whether the company has kept proper accounting records and adequate information has been received from branches not visited by the auditors, and 2) whether the company's individual statements are consistent with the accounting records and profits. If the auditors consider that these two requirements have not been met, they are expected to state the fact in their report. The 2006 Act adds that the auditor must render an opinion whether the auditable part of the director's remuneration report is in agreement with the accounting records and returns. In addition, there must also be a comment if the auditors have not received all the information and explanations they consider necessary for the purposes of the audit. Further, the auditors are expected to comment, so far as they are reasonably able to, if the requirements of information disclosure of Schedule 6 (emoluments and other benefits of directors and others) have not been met.

The 2006 Act defines more thoroughly the contents of the audit report than the previous Act. According to the 2006 Act, an audit report must include an introduction that states which annual accounts are the subject of the audit and the financial reporting framework applied in their preparation. Secondly, the audit reports should include a description of the auditing standards according to which the audit was conducted. Further, there are three requirements for the auditors' opinion: it must be clearly stated in the report whether the annual accounts 1) give a true and fair view, 2) have been properly prepared according to the relevant financial reporting framework, and 3) have been properly prepared according to the Companies Act 2006 and where applicable, according to IAS 4. Lastly, the audit report should be either qualified or unqualified and include a reference to matters the auditor may wish to attract attention to without qualifying the report.

According to both Acts, a statutory auditor must conduct all the audits of large and medium-sized limited liability companies, thus exempting small companies from this duty as in other countries. The Acts specify the legally defined role for the auditor. The Acts also require that the auditor's report must be signed and must state the auditor's names and whether in the auditor's opinion the annual statements have been prepared in accordance with the Companies Act and whether a true and fair view is given. Further, the auditors must consider whether the information given in the director's report for the financial year for which the annual statements are prepared is consistent with those statements.

Unlike any other industrialized country, the United Kingdom required a compulsory annual audit for all registered companies irrespective of size until 1994. However, this requirement faced a lot of criticism and therefore the requirement was changed with the issue by the Board of Trade of Statutory Instrument No. 1994/1935, The Companies Act 1985 (Audit Exemption), Regulations 1994, which came into force on August 1994. According to which, no audit is required for companies with turnover under GBP 90 000 and balance sheet total of less than GBP 1,4 million. However, the exemption does not apply, if the company is publicly traded, a banking or insurance company, a registered insurance broker, an operator under the Financial Services Act or a registered trade union body.

In 2004, the auditing standard-setter in the United Kingdom and Ireland, the Auditing Practices Board (APB) issued International Standards on Auditing (ISAs) effective for periods commencing on or after December 15. According to the APB, these national standards for UK and Ireland are based on ISAs issued by the International Auditing and Assurance Standards Board (IAASB). After 2004, IAASB has revised some ISAs. In addition, the 'Clarity Project' was introduced by the IAASB in 2005 in order to enhance the clarity of the international standards by revising or redrafting existing ISAs. This Project was finalized at the end of 2008 after which the APB sought consultation from stakeholders whether to adopt the revised and clarified ISAs. After extensive consultations, the APB released a Press Notice in March 2009 announcing its intentions of updating its auditing standards to incorporate the changes introduced by the Clarity Project. Further, exposure drafts of 33 clarified national ISAs were issued for public comment with the commenting period ending on July 22, 2009. After finalization, the new standards will replace the existing national ISAs and International Standards on Quality Control (UK and Ireland) 1 affecting audits of financial statements for periods ending on or after December 15, 2010

According to ISA 700 (UK and Ireland) The Auditor's Report on Financial Statements, the standards is effective for audit of financial statements for periods commencing on or after December 15, 2004. The standard was revised by the IAASB, but it was not adopted by the APB due to uncertainties over the European Commission and other developments relating to audit reports. Its revision was deferred and it was finally issued in 2009, effective for periods ending on or after April 5, 2009 for UK companies.

Appendix 5: Elements of the Auditor's Report (ISA 700)

The auditor's report when the audit has been conducted in accordance with the ISAs includes the following elements:

a. Title;
b. Addressee;
c. Introductory paragraph that identifies the financial statements audited;
d. A description of management's responsibility for the preparation and the fair presentation of the financial statements;
e. A description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit, which includes:
    i. A reference to the ISAs, and
    ii. A description of the work an auditor performs in an audit.
f. An opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the country of origin4 of the financial reporting framework when IFRS or International Public Sector Accounting Standards (IPSAS) are not used);
g. Where relevant, reporting on any other reporting responsibilities in addition to the responsibility to report on the financial statements;
h. Date of the report;
i. Auditor's signature; and
j. Auditor's address.

Appendix 6: The Division of Auditors

Auditors	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
DELOITTE	3	3	3	3	3	3	2	2	2	2
E&Y	5	5	5	4	4	3	4	4	4	4
KPMG	4	4	4	5	4	5	6	6	6	6
PWC	6	6	6	7	7	7	7	6	6	6
OTHERS	2	2	2	1	2	2	1	2	2	2

Table 14: Division of auditors

In Table 14, the ‘Other auditors’ line includes the companies audited by Mazars and BDO.