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Incorporation of Audit Firms in the UK:
Survey Evidence

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Incorporation of Audit Firms in the UK: Survey Evidence

Abstract

The Eighth EU Directive (on the qualifications of auditors) was implemented in the UK through the Companies Act 1989. The UK legislator decided to introduce the Directive's option allowing audit firms to incorporate, which was previously prohibited. By 1995, the possibility of incorporation had been taken up by only a few UK firms, mainly small ones. KPMG incorporated part of their UK firm in 1995, and some other Big Five firms are currently considering incorporation or the forming of limited liability partnerships. This paper examines the reasons for and against incorporation of UK audit firms, mainly from the profession's point of view. It also looks at the impact of the Eighth Directive on UK regulation and at the accounting profession's rules for incorporation, which go beyond those of the Directive. It further reports some findings of a survey of the 121 audit firms which had registered as corporate entities by September 1995. The characteristics of firms which incorporated are reported. Hypothesis tests which attempt to explain the incorporation choice are developed. Results suggest that age and cultural background of the audit firm's owners, but not firm size, play a role in the likelihood of the firm operating as a limited liability company rather than as a traditional partnership.

Incorporation of Audit Firms in the UK: Findings of a Survey.

Abstract

The Eighth EU Directive on the qualifications of auditors was implemented in the UK through the 1989 Companies Act. The UK legislator, after a long consultation period, decided to introduce the Directive's option allowing audit firms to incorporate, which was previously prohibited. By 1995, the possibility of incorporation had been taken up by only a few UK firms, mainly small ones. KPMG incorporated part of their UK firm in 1995, and some other Big Five firms are currently considering incorporation or the forming of limited liability partnerships. This paper examines the reasons for and against incorporation of UK audit firms, mainly from the profession's point of view. It also looks at the impact of the Eighth Directive on UK regulation and at the UK accounting profession's rules for incorporation, which go beyond those of the Directive. It further reports some findings of a survey of the 121 UK audit firms which had registered as corporate entities by September 1995. The characteristics of firms which have incorporated are reported. Hypothesis tests which attempt to explain the incorporation choice are developed. Results suggest that age and cultural background of the audit firm's owners, but not firm size, play a role in the likelihood of the firm being formed as a limited liability company rather than as a traditional partnership.

INTRODUCTION

Incorporation of audit firms is a relatively new concept in the UK. It was first made possible by the Companies Act 1989, which implemented the Seventh and Eighth EU Directives. Incorporation offers a means of protecting the personal assets of audit firms' principals in cases of litigation. Both corporate entities and the limited liability partnership are becoming more popular as legal forms for audit firms in the US, which, to a larger degree than the UK, experiences cases of litigation against auditors. The corporate form is also a common legal form for large audit firms in most Continental European countries.

KPMG incorporated the part of its firm dealing with the audit of listed clients in 1995, and other large UK firms are contemplating incorporation or, as an alternative, registration as limited liability partnerships. The incorporation of KPMG Audit Plc (the arm of KPMG responsible for auditing listed clients) at the end of 1995 attracted considerable attention, particularly because it suggested a desire by large audit firms to limit their partners' liability. However, little is publicly known of the mainly small firms which incorporated earlier than KPMG did.

This is a two-part paper. Part 1 examines the advantages and disadvantages of audit firm incorporation, looks at the impact of the Eighth Directive on UK regulation and documents the UK accounting profession's view and its additional rules for incorporation, which go beyond those of the Directive. Part two summarises some of the results of an exploratory study of UK corporate audit firms. This survey evidence provides descriptive data on the nature of these firms and is used to test hypotheses regarding the incorporation decision. This is, to our knowledge, the first systematic empirical evidence to be presented on this issue in the UK.

REGULATION

The Eighth Directive

Prior to the UK implementation of the Eighth EU Directive,¹ it was not possible in the UK for a corporate body to be appointed as a company auditor. This prohibition² dated from the Companies Act 1928 and had been instigated by the Institute of Chartered Accountants in England and Wales (ICAEW):

... on the grounds that only individual auditors were in a position to express a personal audit opinion and take full responsibility for that opinion. This in turn reflected the general accepted view of the time that the partnership structure was the appropriate form of business organisation for professional men. (Department of Trade and Industry, 1986:61)

However, in a number of other countries, including some other EU members, no similar restriction existed. The Eighth Directive, which was adopted by the EU in 1984, allowed both individuals and firms to be approved as auditors, with "firm" referring to either a partnership or a corporate entity. However, to ensure auditor independence, the Directive (Article 2 (1) (b)) imposed the following conditions (with a few exceptions):

- individuals carrying out audits on behalf of firms must fulfil the Directive's requirements for the approval of auditors;
- the majority of voting rights must be held by individuals or firms fulfilling these requirements; and
- the majority of members of management and administrative bodies must be persons or firms fulfilling these requirements.

Further, Article 27 specifies that:

Member States shall ensure at least that the members and shareholders of approved firms of auditors and the members of the administrative, management and supervisory bodies of such firms who do not personally satisfy the conditions ... do not intervene in the execution of audits in any way which jeopardizes the independence of the natural persons auditing the documents ... on behalf of such firms

Implementation of the Directive in the UK

It was contentious whether or not the UK should implement the Directive's option to allow audit firms to incorporate. In a Department of Trade and Industry consultative document published in 1986 (DTI, 1986), the perceived advantages and disadvantages (for the profession and other interested parties) of such a move were identified and discussed. The advantages were seen to be that:

- incorporation would better enable companies to adopt management structures corresponding to their size and business diversity;
- firms could more easily compete with companies in other industries in attracting specialist staff (e.g. by offering perks such as share ownership and by avoiding the conflict inherent in the requirement for all partners of accounting firms to be accountants);
- incorporation would have certain financial advantages, in particular with reference to raising capital;

- it would place UK audit firms on a similar footing to that of incorporated firms in other European countries - this would have advantages with respect to competition and rules on mutual recognition;
- other financial services companies might be able to be authorised to audit if they met the legislation's minimum requirements; and
- there might be certain advantages with respect to limiting auditors' liability.

The disadvantages were seen to include:

- the partnership structure, which places responsibility on the individual partners, might still be felt to be more appropriate;
- lack of personal liability, and the possibility of non-auditors as part-owners, would represent a risk to independence and integrity;
- Directors or employees of audit firms would have less incentive for "adopting the highest professional standards" (DTI, 1986:67); thus, the quality of service provided would be reduced;
- outside ownership might negatively affect partners' commitments to the firm.

The Companies Act 1989 (section 25) finally lifts the restriction on corporate entities, allowing individuals or firms to be auditors, as long as they are members of a Recognised Supervisory Body (RSB) and eligible to audit under the Body's regulations. These provisions came into force on 1 October 1991. The four professional bodies whose members were authorised to carry out statutory audits in the UK before the 1989 Companies Act were granted status as RSBs:³

- the Institute of Chartered Accountants in England and Wales (ICAEW);

- the Institute of Chartered Accountants of Scotland (ICAS);
- the Institute of Chartered Accountants in Ireland (ICAI); and
- the Association of Chartered Certified Accountants (ACCA).

The View of the Profession

Although it appears that, to an extent, the UK accountancy profession welcomed the government's decision to drop the prohibition on corporate auditors, the proposed change met with as much hesitation as enthusiasm. In particular, it was suggested that neither the Directive nor the 1989 Act went far enough to ensure independence.⁴ There was, in particular, concern about shareholdings by outsiders, i.e. persons who were not members of one of the professional bodies, and therefore not subject to their rules. It was said that this might lead to greater emphasis on profit as opposed to independence and integrity.⁵

These considerations led the three Institutes, in their roles as RSBs, to introduce the following stricter requirements (ICAS, 1991):

- i) 75% of the voting rights in the company and on the board of directors or other management bodies must be held by "qualified individuals"⁶ and/or registered auditors who mainly work for the company in question;
- ii) each director must be a member of one of the Institutes or of the Association, or a "regulated non-member" or a registered auditor; and
- iii) further rules require notification of shareholdings and empower directors, under certain circumstances, to disenfranchise shareholdings.

The ACCA does not require 75% of voting rights etc. to be held by auditors. It merely requires control of the simple majority of voting rights by qualified persons or, where decisions are not made through exercise of voting rights, that the power to influence policy or to change the firm's constitution is held by such persons (ACCA, 1995).⁷

The Institutes' stricter rules led the DTI and the Director General of Fair Trading to express concern regarding their detrimental effect on competition (see Richards, 1990 and *CA Magazine*, 1991). However, the Institutes pointed out that lack of control of firms by auditors might endanger independence by leading to greater emphasis on profitability as opposed to integrity, and that it might not be enough to guarantee control if auditors were required merely to hold a majority of the voting rights (*CA Magazine*, 1991). (Other possible motivations for the restriction could of course have been an attempt to limit the number of outsiders, i.e. to retain the profession's monopoly over audit, and possible fear of loss of reputation.⁸

It appears that, possibly due to the profession's self-imposed restrictions, there was no immediate interest in incorporation, in particular not from the large firms:

The larger practices have welcomed the Institutes' move but also have no intention of taking advantage of the provision. As Mr Couse [the ICAEW president] himself said: 'Personally speaking, I, with my partners, feel a mutual responsibility which we could lose over a period of time if we incorporated.'

With just 25% of the voting rights to be made available, any firms wishing to incorporate might find it difficult to find willing investors. The only offer to be

made so far has come from 3i, and that was made on the basis of a 49% shareholding.

(*Accountancy*, 1989:9)

SURVEY EVIDENCE

Incorporated UK Audit Firms

In September 1995, 90 corporate entities were registered as auditors with the ICAEW, 29 with the ACCA and two with two other bodies.⁹ They had registered over the four previous years as shown in Table 1.

Year	ICAEW		ACCA	
	Number	%	Number	%
1991 (part)	4	4%	6	21%
1992	8	9%	7	24%
1993	15	17%	3	10%
1994	34	38%	8	28%
1995 (part)	29	32%	5	17%
Total	90	100%	29	100%

(Source: compiled from information on the Joint Audit Register)

The first registrations with the ICAEW occurred in September 1991 (i.e. surprisingly, *before* the relevant provisions of the 1989 Companies Act had come into force). The first registrations with the ACCA were on 1 October 1991 (the commencement date of the provisions). The figures for 1991 and 1995, therefore, do not represent full years.¹⁰ Further, a number of firms which did initially register are no longer included on the current Joint Audit Register (JAR) and are, therefore, not in Table 1.^{11 12}

It appears from Table 1 that, for the ICAEW, there was a small increase in the number of firms registering each year. For ACCA firms, initial enthusiasm for registration seems to have been proportionally greater than for the ICAEW firms, but this dropped in 1993, only to increase again in 1994.

Development of Hypotheses

The exploratory hypotheses examined here were based mainly on expectations resulting from the review of the preliminary data gathered from the JAR, since literature available on the subject is very limited.¹³ Not all of the authors' expectations regarding survey results were amenable for formal hypothesis testing, and these factors are dealt with in a more descriptive manner.

1. Size

Publication of financial statements and statutory audit thereof may be considered to be the “price” of incorporation. For small firms, the issue of disclosure is less relevant and less of a deterrent to incorporation than it may be for the Big Five, since, for the smallest UK firms, an important disadvantage of incorporation had been removed with the introduction of the small company audit exemption in 1994.¹⁴ It was therefore anticipated that a large proportion of the incorporated firms would be small enough (by turnover) to fall outside the audit requirement. This expectation was further strengthened by the fact that, for both the ICAEW and the ACCA, the greatest proportional increase in the number of corporate audit firms occurred when the audit exemption was introduced, i.e. from 1993 to 1994 (see Table 1). Unfortunately, comparative data on turnover, assets or number of employees is not available for all audit firms. Thus, the number of principals and the number of offices were chosen as

proxies for size, since these data were available for all firms (whether incorporated or not) and could thus be compared.

It was expected that incorporated firms would be those with a small number of principals and offices (e.g. between one and four principals, one to two offices). The following directional hypotheses were formulated (stated in the alternative form):

H1: Incorporated firms are smaller by number of principals than unincorporated firms.

H2: Incorporated firms are smaller by number of offices than unincorporated firms.

Further, the following expectation was formulated, but, due to lack of comparative data for all firms on turnover, assets, or number of employees, it could not be tested formally:

Incorporated firms are those eligible for the Companies Act's small company exemptions.¹⁵

2. Age

It was expected that younger accountants would be more open to fundamental changes, and would therefore be more willing to incorporate. Also, incorporated businesses might tend to be new ones, where the owners would not have to worry about the disadvantages involved in the discontinuation of a partnership. New businesses are likely to be founded by younger accountants. Thus:

H3: Principals of incorporated firms are younger than principals of all firms.

3. Culture

It was further expected that the principals' cultural backgrounds would affect their willingness to incorporate. As pointed out above, the prohibition against incorporation of audit firms (Companies Act 1985, section 389 (6)) dated from the 1928 Act and had been instigated by the ICAEW because it was felt that auditors should take full responsibility for the audit opinion. It was felt that this might have been a notion held particularly strongly by the Anglo-American accounting/professional culture, whereby culture is interpreted in a wide sense (i.e. wider than, for example, by Hofstede (1984) and Gray (1988)¹⁶) including the influences of institutions and traditions, for example corporate ownership and corporate governance. Further, it was thought that those from other cultures might be less attached to the British traditions in general and therefore be more open to change. It might, therefore, be argued that firms whose principals had been brought up in other cultures would be more likely to opt for incorporation. Thus, it was anticipated that the survey sample would contain a larger proportion of firms with principals influenced by other national and accounting/professional cultures than would be average for the respective RSB. Place of birth was chosen as a proxy for culture.¹⁷ The following hypothesis was formulated:

H4: A larger proportion of principals in incorporated firms was not born in the UK or Ireland compared to principals of all firms.

Survey Methods

Initially, the names and addresses of all UK incorporated audit firms were obtained from the respective RSBs. Further information was gathered from the JAR on number of offices, date of registration as registered auditors and number (and names) of principals (directors). Unfortunately, due to the JAR's 'teething problems', it was found that these data were not

available in all cases. Therefore, the help of the ICAEW, the ICAS and the ACCA was obtained in gathering this information about the corporate firms, which should have been publicly available. Further, in those cases where either the required data could not be obtained or where inconsistencies existed between those obtained from the RSBs and the JAR, telephone calls were made to the audit firms prior to sending out the questionnaire in order to gather the correct information.

After an initial pilot study, a questionnaire survey of all the 121 corporate audit firms then registered was carried out in September-October 1995. A follow-up letter and another copy of the questionnaire were sent to firms which had not responded approximately three weeks after the original questionnaire had been sent.

The questionnaire invited respondents to check, amend and supplement data about their firm that should be publicly available on the JAR. Further questions covered, *inter alia*, age and country of birth of shareholders, ownership structure of the firm, turnover, etc. Ranges for staff numbers, turnover and asset size were chosen to indicate eligibility for the Companies Act's small company exemptions¹⁸ and for the audit exemption.

To test the above hypotheses, corresponding information on the total population of *all* audit firms, i.e. incorporated and unincorporated firms, was obtained. Data on number of offices and principals were obtained from the relevant RSBs' annual reports to the DTI, while data on age and place of birth of principals was available directly from the ICAEW and the ACCA.¹⁹ Population data on the size proxies were adjusted to exclude the incorporated firms to form an unincorporated comparison group for the two size hypotheses. However, this was not practical for age and place of birth and hence the comparison group is all companies.²⁰

Survey Results

Questionnaires had been sent to the entire population of the 121 incorporated firms²¹, thus eliminating sampling bias. Completed questionnaires were returned by 64 respondents (52.89%), comprising 47 ICAEW firms (47/90 = 52.22%), 1 ICAS firm (1/1 = 100%), 16 ACCA firms (16/29 = 55.17%) and no AAPA firm (0/1 = 0%). There appeared to be no non-response-bias.²² Because there was only one incorporated audit firm registered with the ICAS, it will not be considered further in the analysis below.

Size

Table 2 summarises the incorporated firms' average (mean) number of principals and offices and compares these to the average number of principals and offices of unincorporated firms.

Table 2: Mean Number of Principals (Directors/Partners) and Offices		
	Principals	Offices
Survey: all respondents	1.89	1.22
Unincorporated - ICAEW	1.85	1.19
Unincorporated - ACCA	2.00	1.31
ICAEW firms	2.10	1.26
ACCA firms	1.37	1.15

To test hypotheses 1 to 4, the sample was additionally split between ICAEW and ACCA firms. This split suggested itself because of the differences between these two RSBs with regard to membership characteristics and different rules (for example regarding auditor authorisation, as explained above). Z tests showed that H1 and H2, regarding size, could not be accepted (at the 10% level) for either group. Moreover, findings for the ACCA firms were not in the predicted direction.^{23 24} It appears, therefore, that the anticipated size differential between incorporated and unincorporated firms does not hold true, at least as far as the above proxies for size are concerned.

One interesting observation became apparent relating to the number of principals: two-principal firms form the largest group in the survey (ICAEW: 47%, ACCA: 56%), whereas sole traders form the largest group among all firms (ICAEW: 68%, ACCA: 77%). It appears, therefore, that firms with two principals were more likely to opt for incorporation than were sole traders. A possible explanation for this may be that incorporation offers a more tax-efficient way of providing one's spouse (as the other principal) with an income stream, by making him/her a director and/or shareholder.²⁵ An alternative explanation relates to the easier change of ownership/succession in an incorporated firm, which may be less relevant to one-principal firms than to two-principal firms. It follows that the relationship between size and probability of incorporation is not uniformly linear, as originally hypothesized.

Additional observations in this section concern associations between firm characteristics and choice of incorporated status which are not formally tested because of the lack of corresponding data on unincorporated firms. Table 3 shows that all respondents qualified for the Companies Act's small company disclosure and publication exemptions. Of the total of 62 respondents giving details of turnover, 83.9% would additionally qualify for the small company audit exemption: at the time of the survey more than half (53.2%) would have been completely exempt, while 30.6% would have required only an exemption report. Only ten firms (16.1% of valid replies) would have required a full audit. These findings suggest that, as expected, incorporated firms tend to be those which are exempt from disclosure and audit requirements.

No of Staff	All respondents (incl. ICAS)	ICAEW	ACCA
1-10	52 (81.3%)	39 (83%)	12 (75.0%)
11-20	10 (15.6%)	8 (17%)	2 (12.5%)
21-30	1 (1.6%)	0	1 (6.3%)

31-50	1 (1.6%)	0	1 (6.3%)
51-250	0	0	0
over 250	0	0	0
Turnover²⁶			
up to £90,000	33 (53.2%)	22 (48.9%)	11 (68.8%)
£90,001 - £349,999	19 (30.6%)	17 (37.8%)	1 (6.3%)
£350,000 - £2.8m	10 (16.1%)	6 (13.3%)	4 (25.0%)
Assets			
up to £1.4m	62 (100%)	45 (100%)	16 (100%)

Age

The average age of ICAEW partners (principals) in practice was 48 years, while the average age of ACCA registered auditors was 45 years.²⁷ For survey respondents, the average age of directors was 42 years (ICAEW) and 43 years (ACCA), respectively. Z tests show that H3 can be accepted (at the 1% level for ICAEW principals, and at the 10% level for ACCA principals), i.e. the principals of incorporated firms are slightly younger than those of unincorporated firms.

Culture

A total of 31 (26.05%) of the survey's 119 directors had not been born in the UK or Ireland: 18 of the 87 ICAEW directors (20.69%) and 13 (40.64%) of the 32 ACCA directors. By contrast, the proportion of all ICAEW and ACCA UK registered principals not born in the UK is 6.99% and 11.34%, respectively (but see the limitation below). H4 is confirmed by z-tests (at the 1% level).

	No. of Principals	No. of Offices	Age	Origin
Full Sample:	not sign.	not sign.	sign. at 1% level	sign. at 1% level
Sub-samples:				
ICAEW	not sign.	not sign.	sign. at 1% level	sign. at 1% level
ACCA	not in exp. dir.	not in exp. dir.	nearly sign. at 5% level	sign. at 1% level

This is the first empirical study of audit firm incorporation in the UK, and is thus exploratory. There are four principal limitations. First, not all expectations could be expressed and tested as formal hypotheses, since in some cases no data were available for comparison with the total population. Second, ranges are used in the survey questionnaires to obtain data on the age of directors, and data on the number of principals, number of offices and age of principals for the total population of incorporated and unincorporated firms were also only available in ranges. This reduces the accuracy of the means calculated. Third, there may be a problem with the comparability of data concerning principals between the survey sample and the total population. Although for both partnerships and limited liability companies (a proportion of) principals may now be non-qualified insiders or outsiders, this is possibly more common with incorporated firms. Finally, place of birth was chosen as a proxy for culture. This was due to the fact that it may well be a better indicator of cultural influences than ethnic background, and that no or little information on the ethnic background of the total population would have been available for comparison. The information was not complete for ICAEW members: of the 20,900 total UK based partners/principals, country of birth was not available for 6,562, i.e. 31.40%.²⁸ The proportion applied in the hypothesis test is based on the total number for which the information was available.

SUMMARY AND CONCLUSIONS

This paper discusses the effect of removing the UK's prohibition on statutory auditors being corporate entities. It reports findings from a survey of UK audit firms which had incorporated by September 1995. These findings support the proposition that incorporated audit firms were small enough to qualify for the CA small company disclosure and publication exemptions and that a large majority was also exempt from the audit requirement. However, the hypothesis that survey firms would be smaller than unincorporated firms was not

confirmed. It appeared, however, that incorporation was more attractive to two-principal firms than to sole traders, suggesting a non-linear relationship between size and probability of incorporation. The hypotheses regarding principals' age and cultural background were confirmed, suggesting that these factors may play a role in the decision to incorporate an audit firm. Further research into the perceived advantages and disadvantages of incorporation is required to develop a richer understanding of the incorporation decision and of, *inter alia*, whether it can relieve the increasing pressure on audit firms created by the threat of litigation. This would underpin the development of a multivariate model of this important choice. Further research into the views of other groups affected, i.e. company directors and shareholders, is also urgently required.

Notes

1. The Eighth Directive was implemented in the UK through Part II of the 1989 Companies Act and through Statutory Instruments 1990/1146 'The Company Auditors (Examinations) Regulation 1990' and 1991/1566 'The Companies Act 1989 (Register of Auditors and Information about Audit Firms) Regulations 1991'.
2. Companies Act 1985, section 389 (6).
3. In 1991 a further body, the Association of Authorised Public Accountants (AAPA), was also recognised as an RSB.
4. See for example KPMG - Peat Marwick McLintock (1987), ICAEW, ICAS, ICAI (1988a), ICAEW, ICAS, ICAI (1988b), etc.
5. See for example ICAEW, ICAS, ICAI (1989), which summarises the response to a previous consultative document (1989).
6. Qualified individuals are those members of one of the three Institutes or the Association who hold appropriate qualifications and (except for the Irish Institute) Practising Certificates. They may also be non-members of these bodies who hold status as a regulated non-member ('affiliate status' in ICAEW regulation) and an appropriate qualification.

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7. The AAPA's rules are identical to those of the ACCA.
 8. In January 1997 the Institutes repealed the "75%-rule"; simple majority is now considered sufficient.
 9. One with the ICAS and one with the AAPA. The ICAS firm was registered on 30 July 1993 and the AAPA firm on 21 April 1993.
 10. Since then there has been a slow but steady increase in the number of incorporated firms.
 11. For example, according to the three Institutes' Report to the DTI for the year ended 30 September 1992, 17 corporate practices had been registered with ICAEW. At the time of writing, only 10 ICAEW firms registering before 30 September 1992 could be found on the JAR.
 12. The JAR is the publicly accessible register of auditors and audit firms maintained jointly by the RSBs. It contains information on an audit firm's partners/directors and shareholders, qualified auditors and offices, etc. It is a requirement of the Eighth Directive and, in the UK, of a Statutory Instrument - see note 1.
 13. At the time the survey was prepared there was no academic literature dealing specifically with the incorporation of UK audit firms, except for discussion documents and similar literature published by the DTI and the professional bodies (see e.g. DTI (1986), KPMG (1987), ICAEW, ICAS, ICAI (1988a & b) etc.) and taxation text books considering the tax consequences of incorporation in general (i.e. not specifically for audit firms).
 14. This exemption was first announced in the March 1993 budget, while actual thresholds were announced in the November 1993 budget. The thresholds were: turnover up to £90,000 - complete exemption from audit requirement; turnover less than £350,000 - audit exemption report required). The exemption was implemented in the summer of the following year. The requirement for an exemption report was repealed in April 1997, thus extending the audit exemption to small companies (except charities) with a turnover up to £350,000.
 15. Exemptions for small and medium-sized companies are dealt with in s.246-249 and in Schedule 8 of the CA 1985. A small company is one that fulfils at least two of the following three conditions: turnover for the year not more than £2.8m, balance sheet total not more than £1.4m and number of employees not more than 50. The exemptions available cover mainly publication, but also to some extent accounts preparation requirements. A small company need not, for example, file a profit and loss account, and only needs to file a summarised version of the balance sheet (see Schedule 8).

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16. C.f. Gray's (1988) model of the relationship between culture and accounting systems, which is based on Hofstede's (1984) cultural dimensions. Gray identifies four accounting values: professionalism versus statutory control, uniformity versus flexibility, conservatism versus optimism and secrecy versus transparency. 'Professionalism', which is a feature strongly associated with the British system, is associated with greater emphasis on professional judgement. It could be argued that this could be impaired by the corporate legal form (as opposed to the partnership), especially where there is outside ownership. However, other partly related factors are relevant, i.e. the perceived importance of auditor independence, which is linked to the systems of corporate ownership and corporate governance. Margerison and Moizer (1996) link culture to auditor licensing in the EU, but do not examine the legal form of audit firms.
17. This was the only characteristic for which some (limited) information for comparison with the total population was available. Further, it seems a more appropriate choice than, for example, ethnical background, since it might be argued that the culture (including education, etc.) into which a person is born and in which they are brought up has a stronger formative effect than, for example, 'race'.
18. Certain exemptions regarding the preparation and the publication of the accounts for small companies, i.e. companies which fulfil two of the three following conditions: turnover up to £2.8m, balance sheet total £1.4m, and up to 50 employees.
19. There is, however, no exact overlap regarding the cut-off dates for this information, i.e. the survey data dates from September/October 1995, while the comparative data regarding size-criteria dates from the reports to the DTI for the year ending 31 December 1994. The comparative data on age and culture was obtained from the ACCA and ICAEW in June 1996.
20. Because of the size of the total population on the one hand and the small number of incorporated firms on the other hand, the comparison with the complement, rather than the total population, does not give significantly different results.
21. In fact, 123 questionnaires were sent out; however, two firms appeared twice on the JAR: one under different names, the other under the same name but as an ICAEW as well as an ACCA firm.
22. To test for non-response bias, the Cramér V coefficient (for attributes) and the Ferber test (for variables) were used. The Ferber test correlates respondents' characteristics with the return date. (Here, the Spearman Rank-Correlation Coefficient was used.) While the Cramér V coefficient showed no non-response bias, the Ferber test indicated positive associations between return date, and the number of directors, shareholders and

auditors on the other hand. However, data on these variables are also available on the JAR for all audit firms and it was therefore possible to carry out tests to compare respondents with non-respondents, which is of course a superior test. In all cases, the test statistic, z , was not in the critical region (not even at 10% level); it appeared therefore that respondents and non-respondents were not significantly different with regard to these characteristics.

23. For ACCA firms the computation of z , or alternatively t , is not really a suitable test because the sample size is very small and the population is very skewed. (However, if z was computed, it would not be possible to reject H_0 at the 10% level.) An alternative test would be to see whether the medians of survey firms and all firms are significantly different, but since both sample and total population have a median of 1, there is no difference.

24. It was also tested whether the proportions of firms having more than one office were significantly different, which was not the case.

25. This would suggest that for incorporated firms, audit principals might be a better proxy for size and for comparison with unincorporated firms than directors. However, z -tests on this basis, although showing a slightly improved result, would still lead to a rejection of hypothesis H2.

26. Two respondents declined to give information concerning turnover and total assets.

Due to the large ranges, working out average turnover would not be meaningful.

27. Correspondence with David Queen, officer of ACCA. Telephone conversation with David Queen, 25 March 1996: 'registered auditors' corresponds to 'principals/partners'. All ACCA principals are also automatically registered auditors, and (surprisingly) *vice versa*, at least as far as these membership statistics are concerned.

28. This type of information has only been collected by the ICAEW since 1978, although Nick Carter (ICAEW), who compiled these data for our benefit, suggested that it would probably also have been retrospectively provided by a number of the principals admitted before 1978.

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