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FOLKETINGET  
RIGSREVISIONEN

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Extract from Rigsrevisionen's report  
submitted to the Public Accounts Committee

# Relief of the statutory audit obligation

# 1. Introduction and conclusion

## 1.1. Purpose and conclusion

1. This report concerns a law amendment passed in 2012, which gave small holding companies the option not to have their financial statements audited by an independent auditor. At the same time, a cheaper alternative to an audit of financial statements was introduced: extended review. Combined, these changes represented the relief of the statutory audit obligation that was introduced in 2012.

2. The study was initiated in June 2018 at the request of the Danish Public Accounts Committee, cf. appendix 1. The committee's request was prompted by the fact that it, in 2018, became public knowledge that the Danish Ministry of Taxation in June 2012 had expressed concern about a proposal put forward by the Danish Ministry of Industry, Business and Financial Affairs (Ministry of Industry) to exempt small holding companies from the statutory audit obligation. The concerns of the Ministry of Taxation appeared from a memorandum, which the ministry had sent to the Ministry of Industry. In the spring 2018, the Ministry of Taxation provided a copy of the memorandum in response to a freedom of information request, and it was subsequently referred to in the media. In the memorandum, the Ministry of Taxation, among other things, expressed concern that a relief of the statutory audit obligation would weaken tax and regulatory compliance significantly, which would widen the tax gap.

3. The study includes the Ministry of Industry and the Ministry of Taxation. The Ministry of Industry is responsible for the administration of the regulations governing the statutory audit obligation that are contained in the Danish Financial Statements Act. It appeared from the bill on the relief of the statutory audit obligation in 2012 that specific measures were to be implemented to avoid any unintended consequences of the relief. For instance, the Ministry of Industry was to evaluate holding companies' option not to have their financial statements audited, with the Ministry of Taxation contributing to the evaluation. The Ministry of Taxation would also be required to enhance its efforts towards the companies that, following the amendment of the law, were now allowed to choose not to have their financial statements audited.

### **Law amendment in 2012**

The subject of this report is the amendment of the Danish Financial Statements Act and the Danish Audit Act, act no. 1232 of 18 December 2012 (bill L 26 2012-13).

### **Holding companies**

This term refers to companies having ownership interests in one or several other subsidiary companies.

### **Extended review**

Extended review of the financial statements is a service to small companies offering a less comprehensive alternative to ordinary auditing. In the extended review, the audit is performed in accordance with a so-called declaration standard adapted particularly to the audit of small companies. Extended review is therefore also referred to as the declaration standard.

4. The purpose of the study is to assess whether the Ministry of Industry and the Ministry of Taxation have implemented a satisfactory effort to counter unintended consequences of the audit obligation relief in 2012. The report answers the following questions:

- What information did the Ministry of Industry give to the Danish parliament in connection with the introduction of the bill on the relief of the statutory audit obligation in 2012?
- Has the Ministry of Industry, in connection with the relief in 2012, implemented a satisfactory effort to counter errors and fraud in the affected companies' financial statements?
- Has the Ministry of Taxation, in connection with the relief in 2012, implemented a satisfactory effort to ensure that the companies concerned pay the tax they are required to pay?



## Conclusion

It is Rigsrevisionen's assessment that the Ministry of Industry and the Ministry of Taxation have failed to implement a satisfactory effort to counter unintended consequences of the relief of the statutory audit obligation in 2012.

It appeared from the bill on the statutory audit obligation relief that the Danish Business Authority, three years after the adoption of the bill, was to evaluate whether the holding companies' option not to have their financial statements audited had any unintended consequences. The evaluation was to be completed in 2016, but was not carried out until 2018. Rigsrevisionen finds it unsatisfactory that the Ministry of Industry has not delivered on its promise to the Danish parliament in connection with the introduction of the bill. Rigsrevisionen considers it an aggravating factor that the Danish Business Authority at the same time suspended its annual follow-up on the consequences of the relief of the statutory audit obligation, which had been standard practice since the audit obligation was first relieved in 2006. Moreover, in 2015, a draft analysis carried out by the Danish Business Authority indicated that the first year after the relief of the audit obligation, there were more errors in the financial statements of holding companies that had not been audited compared with other small companies that had also chosen not to have their financial statements audited. Despite these indications, the Danish Business Authority did not initiate the agreed evaluation that was scheduled to be carried out immediately after the analysis. The Ministry of Industry has apologised to the Danish parliament and explained that the evaluation was not carried out at the time agreed due to an oversight.

The Danish Business Authority does not hold all the information required to determine whether companies that decide not to have their financial statements audited are entitled to do so. This information includes data from the Danish Customs and Tax Administration (SKAT) on penalty notices and judgments. This is not considered satisfactory by Rigsrevisionen. The Ministry of Industry should ensure that the ministry is positioned to enforce the law.

As part of the pre-legislative phase, the Ministry of Taxation made the assessment that SKAT's monitoring of companies that were given the option not to have their financial statements audited would need to be increased by approximately 10 man-years. The study showed that SKAT has not had particular focus on or increased its effort towards these companies, nor is SKAT able to determine the amount of resources it has spent on checking the companies. In connection with Rigsrevisionen's study, SKAT worked out a statement showing that companies that had chosen not to have their financial statements audited were subjected to control by SKAT in the years following the relief. SKAT's contribution to the Danish Business Authority's evaluation was delayed and was not available until 2018. The Ministry of Taxation had no knowledge of the tax consequences of the relief prior to the completion of the evaluation. In spite of the Ministry of Taxation's concerns about giving holding companies the possibility not to have their financial statements audited, SKAT has neither increased its control effort after the law amendment nor prior to 2018 recorded any data on the tax consequences of the relief. This is not considered satisfactory by Rigsrevisionen.

As mentioned, the Ministry of Taxation was concerned about giving holding companies the option not to have their financial statements audited. The Ministry of Taxation communicated its concerns to the Ministry of Industry in 2012 during the pre-legislative phase that led up to the introduction of the bill. The Ministry of Taxation was of the opinion that it would have negative consequences for the companies' tax bill. The concerns of the Ministry of Taxation are reflected in the bill, which states that an evaluation of the relief should be carried out to counter unintended consequences. Because the Ministry of Taxation ultimately supported the bill, its preliminary concerns were not reflected in the bill, as is standard practice in a pre-legislative phase. Rigsrevisionen notes that relevant organisations were not consulted on the part of the bill that concerned holding companies' exemption from the audit obligation. Rigsrevisionen notes that this information was not communicated clearly to the Danish parliament.

The study also showed that the Ministry of Industry has not had particular focus on whether the exemption of the holding companies from the audit obligation has eased the administrative burden on the companies to the extent expected. As regards extended review, the Ministry of Industry's own statements show that the savings achieved by the companies are far from the estimate made by the Ministry of Industry, when the bill was introduced in 2012.

It appears from the evaluation made by the Danish Business Authority in 2018 that the financial statements of holding companies that have not engaged the services of an independent auditor are more affected by errors than those that have been independently audited. It has however, not had any significant impact on the level of error which type of audit services the companies have received. It is not possible for the Ministry of Industry to determine whether the financial statements include errors that would have been detected in an audit. It appears from SKAT's contribution to the evaluation made by the Danish Business Authority that the tax compliance of small holding companies that have had their financial statements audited and those that have not, is the same. At this point, the Minister for Industry, Business and Financial Affairs has not decided how to follow up on the results of the evaluations.