EXECUTIVE SUMMARY

AUDITING OF ACCOUNTS IN COMPANIES

PART I
ARE AUDITED COMPANIES DIFFERENT?

AUDITORES
Instituto de Censores Jurados de Cuentas de España

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AUDITING OF ACCOUNTS IN COMPANIES

PART I ARE AUDITED COMPANIES DIFFERENT?

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September 2020

AUDITORES
Instituto de Censores Jurados de Cuentas de España

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Letter from the president

Audit is an essential asset in the transparency of financial markets and the professionalisation of companies. This is a reality that no one doubts, and, in fact, it is the main reason why its practice is subject to a constant quest for technical and legal improvements that guarantee its efficiency and adaptation to any new challenges that arise.

However, until now, very few studies have been conducted worldwide on the exact effect that auditing has on the various parameters that investors and company management use to make decisions and assess the performance of their companies. This study not only sheds light on this effect, but also provides insight into the extent to which auditing is a differentiating factor between companies that do and do not audit their accounts, with a clear positive influence on their profitability, transparency, indebtedness and job creation capacity.

The conclusions in the section on small and medium-sized companies seem to me to be particularly relevant. In this debate that is taking place worldwide on whether smaller companies need to be audited and on the need to adapt technical auditing standards to the work carried out in them, this report shows that audited SMEs are more profitable, reflect the value of their assets better in their balance sheets and cope better with crises than those that are not audited. This conclusion should lead our legislators and the international bodies to draw up technical standards to reflect on the best way to promote auditing among these types of companies. In this respect, reducing the mandatory limits on statutory audits is a measure that would undoubtedly help small and medium-sized Spanish companies to advance in their professionalisation processes and to access the financial resources they will need to tackle the complex economic situation they are facing, which is why it should form part of the Government's reform agenda without delay.

I hope you find this study interesting, and I encourage you to keep a close eye out for its second part, in which we will analyse in more detail the relationship between auditing and company financial performance, while paying special attention to voluntary work.

Ferrán Rodríguez
President of ICJCE

About us

The Instituto de Censores Jurados de Cuentas de España (ICJCE), created in 1942, is a private institution with its own legal personality, recognised as a public law corporation, which brings together auditors and audit firms.

This institution is representative of auditors and audit firms operating in Spain. It defends the interests of its members and ensures the development and proper functioning of the auditing activity.

Most relevant characteristics of the ICJCE:

- Main representative of the audit profession in Spain.
- Spain's representative in the international bodies (IFAC and AcE) that bring together auditors worldwide.
- More than 5,000 associated professionals.
- Nearly 700 firms.
- ICJCE firms account for 83% of the sector's turnover.
- More than 25,000 people work in ICJCE firms.

Nature of the study and characteristics of the population

The Instituto de Censores Jurados de Cuentas de España (hereinafter ICJCE) has conducted this study of Spanish companies by analysing, for a set of key economic and financial indicators, the performance of companies that are obliged to audit their annual accounts, in accordance with current regulations, with respect to companies that are not obliged to audit their annual accounts, as they do not meet the quantitative requirements established for this purpose.

To conduct the study, the ICJCE has used a database called SABI prepared by Informa D&B, a company specialized in the management of economic and financial information of Spanish companies. The database used includes economic and financial information obtained from the annual accounts filed with the Mercantile Registry by Spanish companies. It also includes financial ratios prepared by the database management company itself, as well as general information on the companies included in the database.

Through this database, a sample of 89,568 Spanish companies has been obtained that are currently active, and that had operating revenues of more than 500,000 euros in the years 2008 to 2018, both inclusive.

The economic and financial indicators that have been analysed and which have also been obtained from the aforementioned specialised database are as follows:

- Net turnover
- Employees
- Total assets
- Indebtedness
- Financial performance
- EBITDA
- Corporate income tax
- Profitability (ROA)

In the sample of Spanish companies analysed on the basis of the criteria indicated in the previous section, companies with NACE "Activities of head offices" and "Activities of holding companies" have not been included, as it has been considered that these activities do not correspond to the development of a business in the strict sense, but rather to obtaining returns from other investees, many of which are already included in the analysed population. Companies whose legal forms correspond to co-operatives, associations, partnerships and limited partnerships, etc. were not considered either, with the analysis focusing on public limited companies and private limited companies.

The breakdown of companies according to whether or not they audit their annual accounts, and their legal form is as follows:

Audited/Legal form	No. of companies	Percentage
Audited	**30.647**	**34,22%**
Public limited company	15.296	17,08%
Private limited company	15.351	17,14%
Non-audited	**58.921**	**65,78%**
Public limited company	9.987	11,15%
Private limited company	48.934	54,63%
Total companies	**89.568**	**100,00%**

One third of the companies analysed audit their annual accounts (34.22%) and two thirds do not audit them (65.78%). Of the companies audited, 50% are public limited companies and 50% private limited companies, while those that are not audited are mainly private limited companies (83%).

Conclusions

This report analyses the trend of various ratios in the audited and non-audited companies during the period 2008 - 2018. The main conclusions that can be drawn from this analysis are:

- The turnover of the audited companies grew more and recovered faster from the 2008 crisis than that of the non-audited companies.

- The audited companies created more employment. By 2018, the audited companies had increased their average number of employees by 14.23% compared to 2008, almost 12 points more than the non-audited companies.

- The value of assets recorded in the accounts of the non-audited companies grew significantly more than that of the audited companies due to the fact that the balance sheets of the former did not record asset write-downs during the crisis.

- The audited companies have lower indebtedness than the non-audited companies.

- The EBIDTA of the audited companies grew threefold over the ten years and withstood the economic crisis better.

- In all the years analysed, the profitability of the audited companies was higher than that of the non-audited companies. Only the profitability of the audited companies has exceeded 2008 levels.

Most of these findings can be extrapolated to the audited SMEs:

- The audited SMEs increased their average sales between 2008 and 2018 by 15.69% and the non-audited SMEs by 6.55%, about nine percentage points difference.

- The audited SMEs increased their average number of employees between 2008 and 2018 by 9.86% and the non-audited SMEs by 2.68%, a difference of more than seven percentage points.

- The assets of the audited SMEs grew less, due to the write-downs they underwent during the crisis.

- The audited SMEs increased their average profits between 2008 and 2018 by 65.20% and the non-audited SMEs by 38%, almost 27 percentage points more in the audited SMEs.

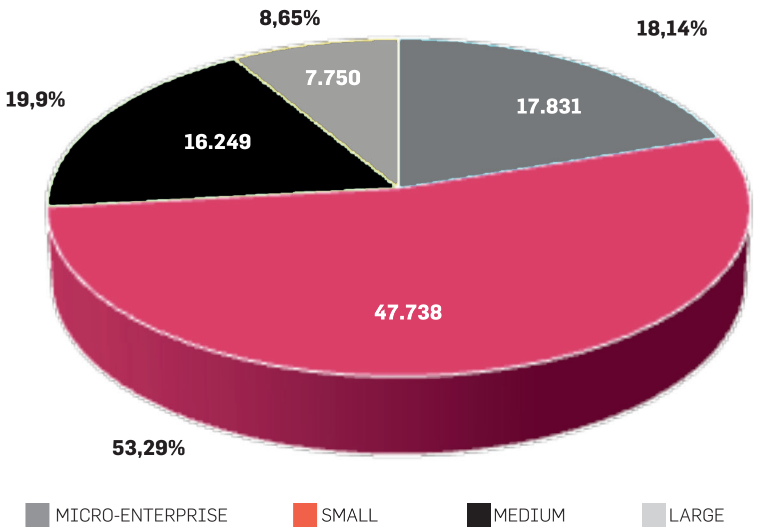
- The audited and non-audited SMEs had an even profitability in 2008 and 2009, but from that year onwards the audited SMEs had a higher average profitability.

Main characteristics observed

The main characteristics observed among the set of companies analysed are:

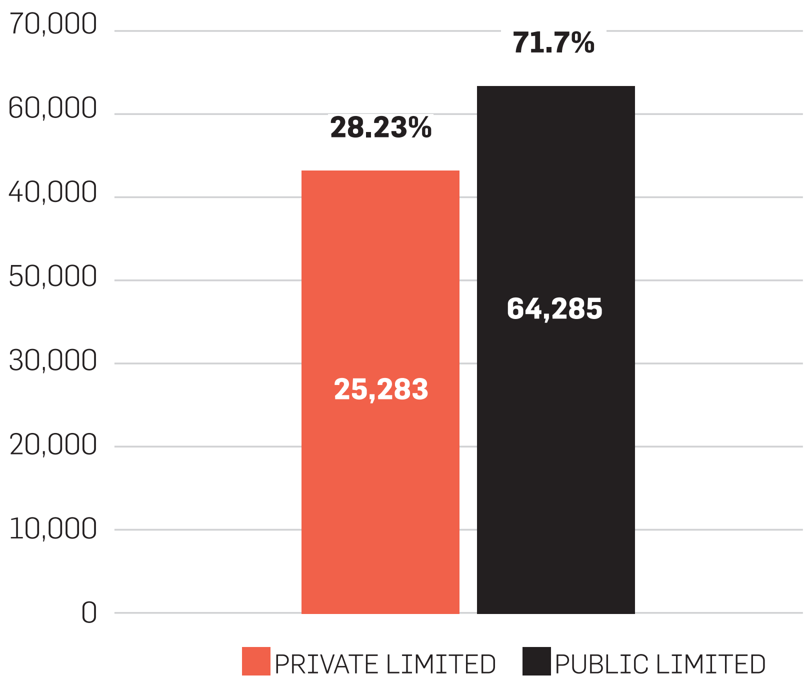
1) 91% of the 89,568 companies analysed are SMEs.

COMPANY SIZE 2018

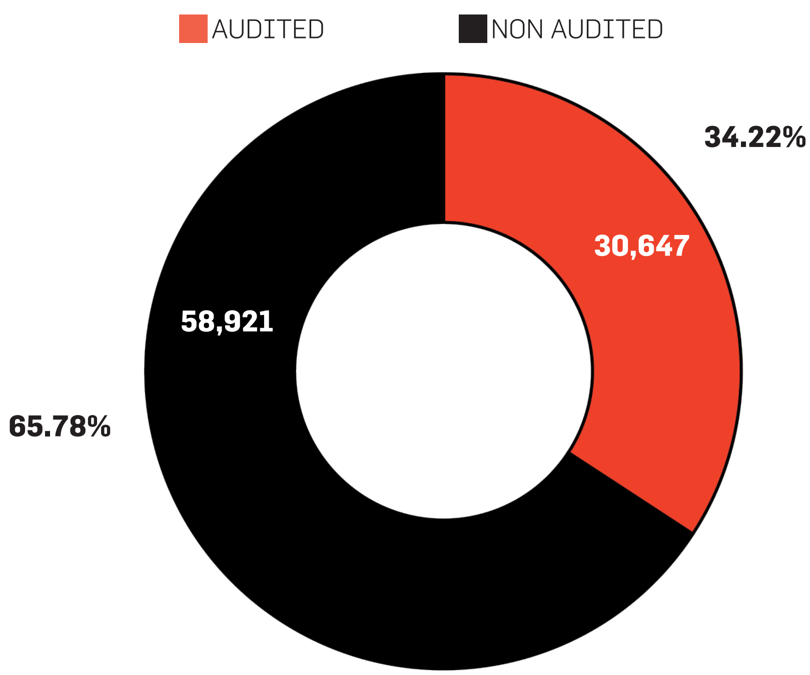


TYPES OF ENTERPRISES - EUROPEAN COMMISSION REGULATION (EU) NO. 651/2014

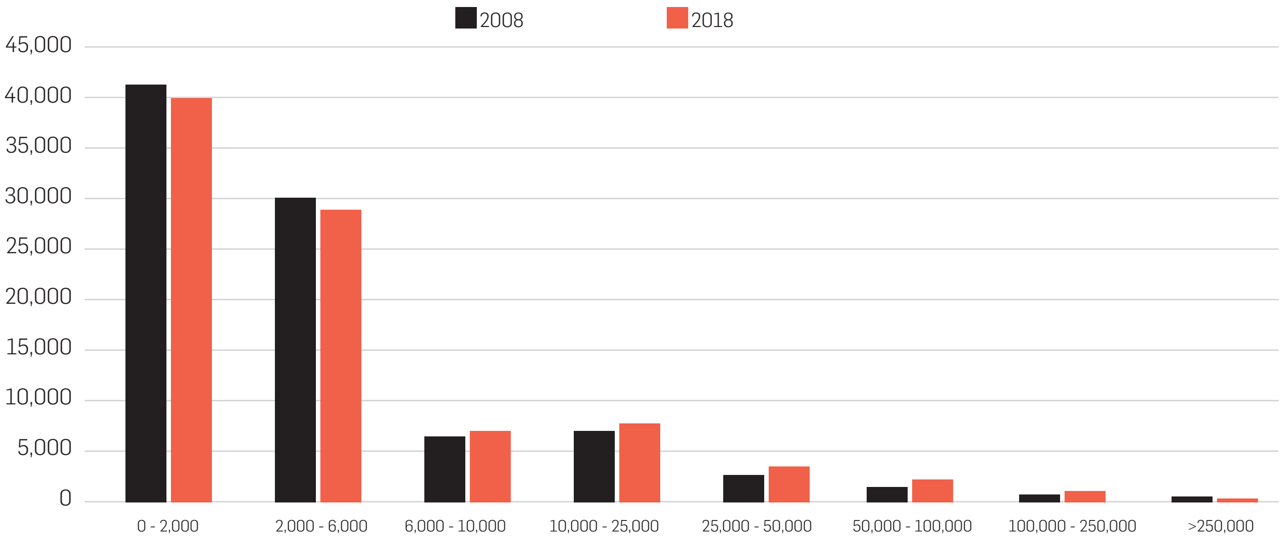
2) One third of the companies are public limited companies



3) One third of the companies audit their accounts

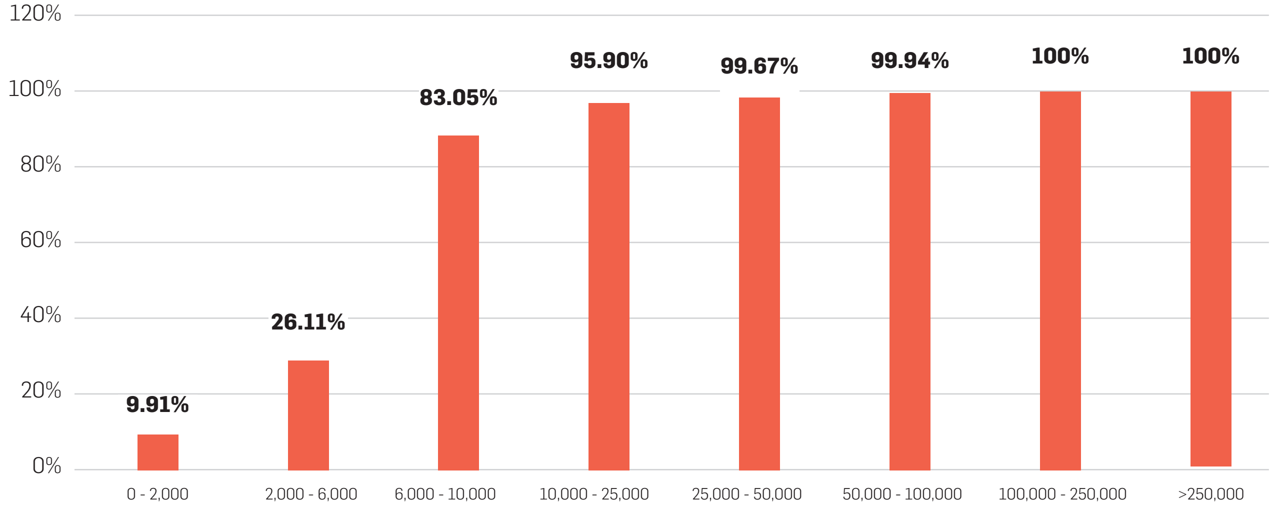


4) 80% of the companies have sales of less than six million euros



NUMBER OF COMPANIES BY SALES RANGE (THOUSAND EUROS)

5) More than 25% of the audited companies have sales of less than six million euros



% OF THE COMPANIES AUDITED BY SALES RANGE

This percentage is relevant because, taking into account the current limits for mandatory statutory audit, this would be an indicative indicator of the approximate percentage of companies that are audited voluntarily.

Indicators analysed

Net turnover

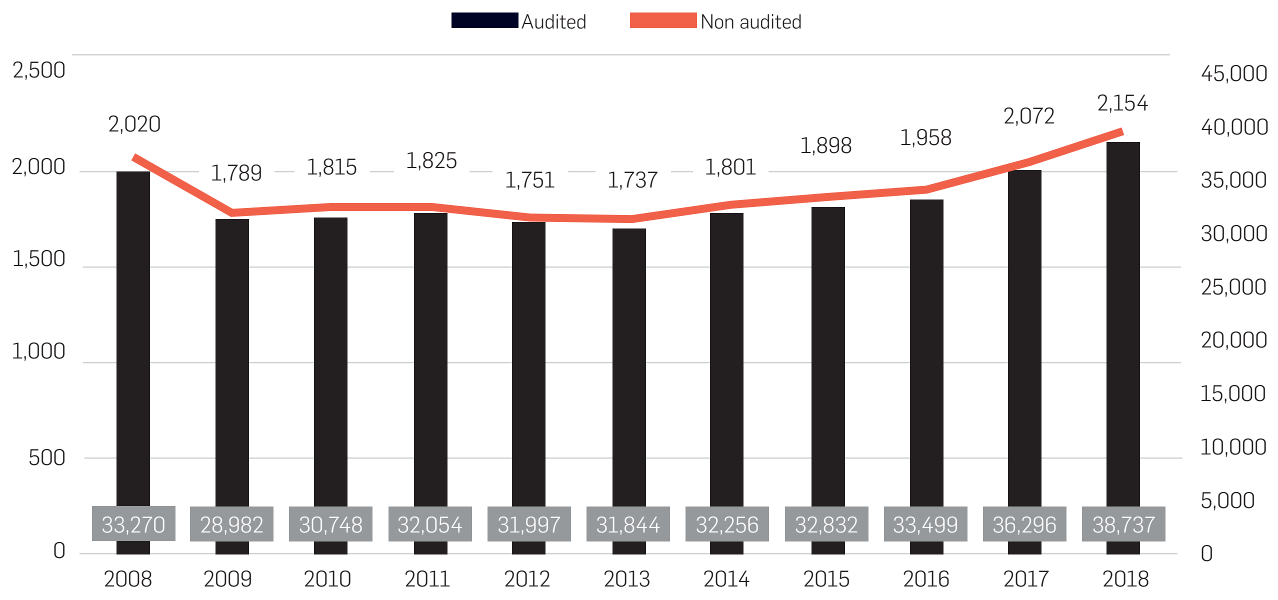
THE AUDITED COMPANIES' SALES GREW BY 10 PERCENTAGE POINTS MORE

The audited companies had average sales in 2018 of 38.74 million euros, an increase of 16.43% compared to their average sales in 2008. The non-audited companies had average sales in 2018 of 2.15 million euros, 6.6% more than in 2008, 9.83 percentage points less than the audited companies.

The average annual rate of sales growth over the ten-year period was 1.7% per year for the audited companies and 0.8% for the non-audited companies, 0.9 percentage points lower.

It took the audited companies eight years to recover the level of revenues they had at the start of the crisis in 2008, while it took one more year for the non-audited companies to exceed the 2008 amount.

Average net turnover (1)



(1) Figures in thousands of euros

Number of employees

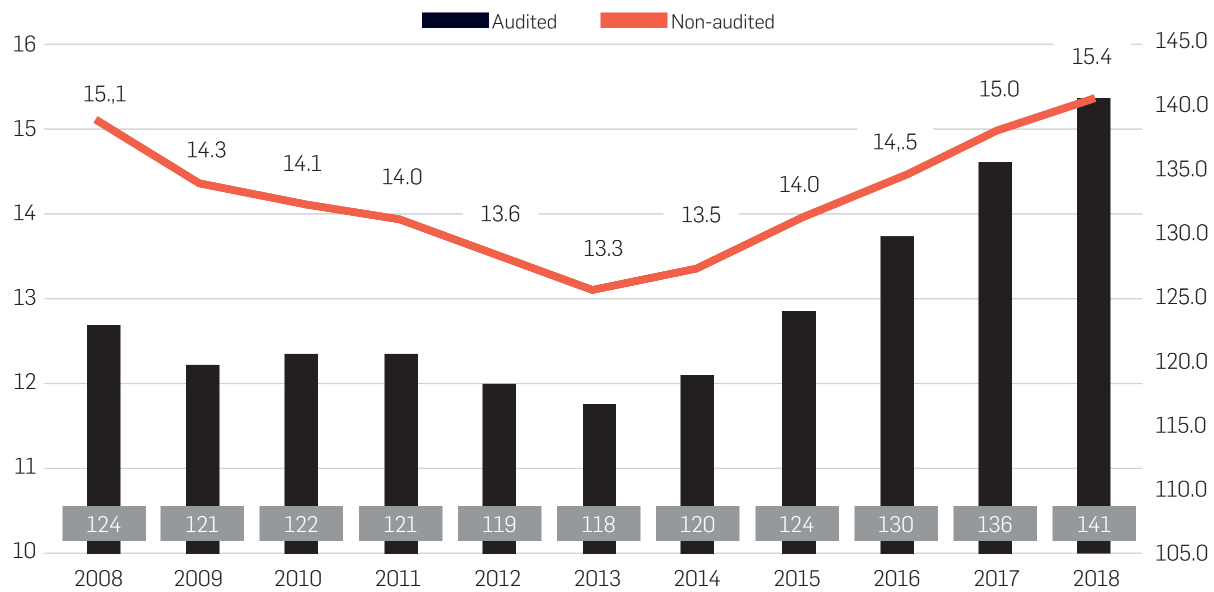
THE AUDITED COMPANIES CREATED MORE EMPLOYMENT OVER THE TEN YEARS

The average annual rate of increase of employees over the ten years was 1.4% for the audited companies and 0.3% for the non-audited companies. The audited companies grew by 1.1 percentage points more than the non-audited companies.

By 2018, the audited companies had increased their average number of employees by 14.23% compared to 2008, while the non-audited companies only increased by 2.4%, 11.83 percentage points less than the audited companies.

The audited companies matched the average number of employees at the beginning of the period in 2015, while the non-audited companies did not manage to exceed that level until 2017.

Average number of employees



Total assets

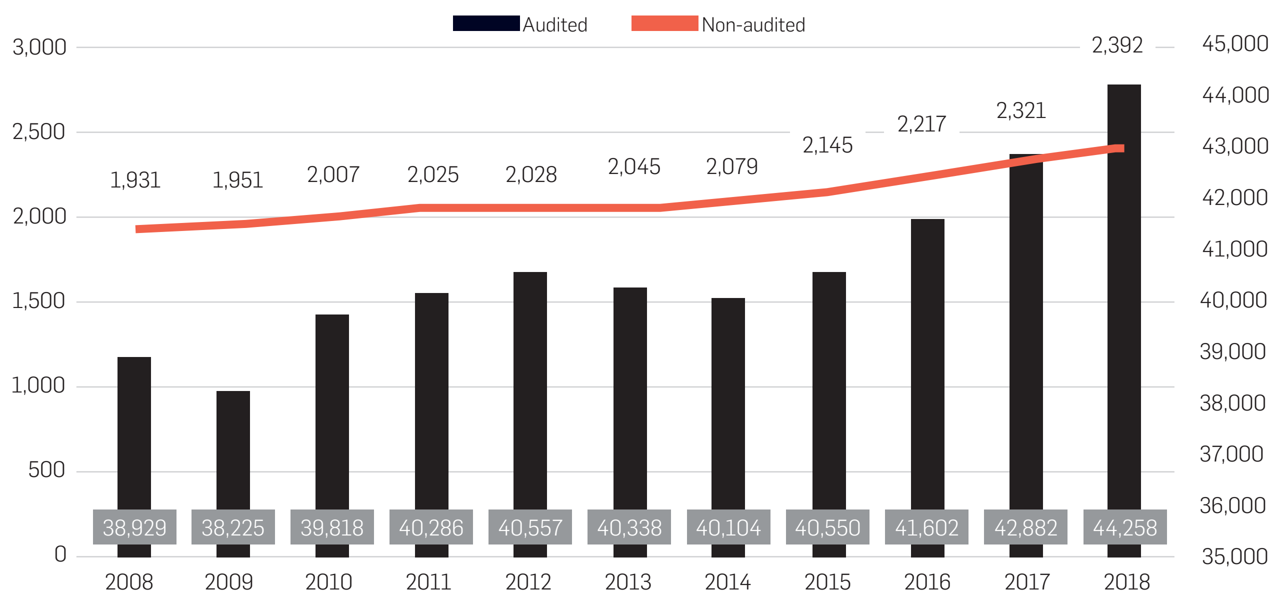
THE NON-AUDITED COMPANIES GREW MORE, BUT THE AUDITED COMPANIES RESTRUCTURED THEIR ASSETS

The average asset value of the audited companies in 2018 was 44.25 million euros, 13.7% higher than in 2008, while the non-audited companies had average assets of 2.39 million euros in 2018, 23.87% higher than in 2008. The non-audited companies increased their assets ten percentage points more than the audited companies.

The audited companies impaired their assets (fixed assets, inventories, customers and financial assets) by EUR 147 million (1.07% p.a.), while non-audited companies impaired EUR 128 million (0.1% p.a.), of which EUR 114 million was realised by only one company in 2014.

The audited companies wrote-down their assets in the crisis, while the non-audited companies did not.

Average profits (1)



(1) Figures in thousands of euros

Indebtedness

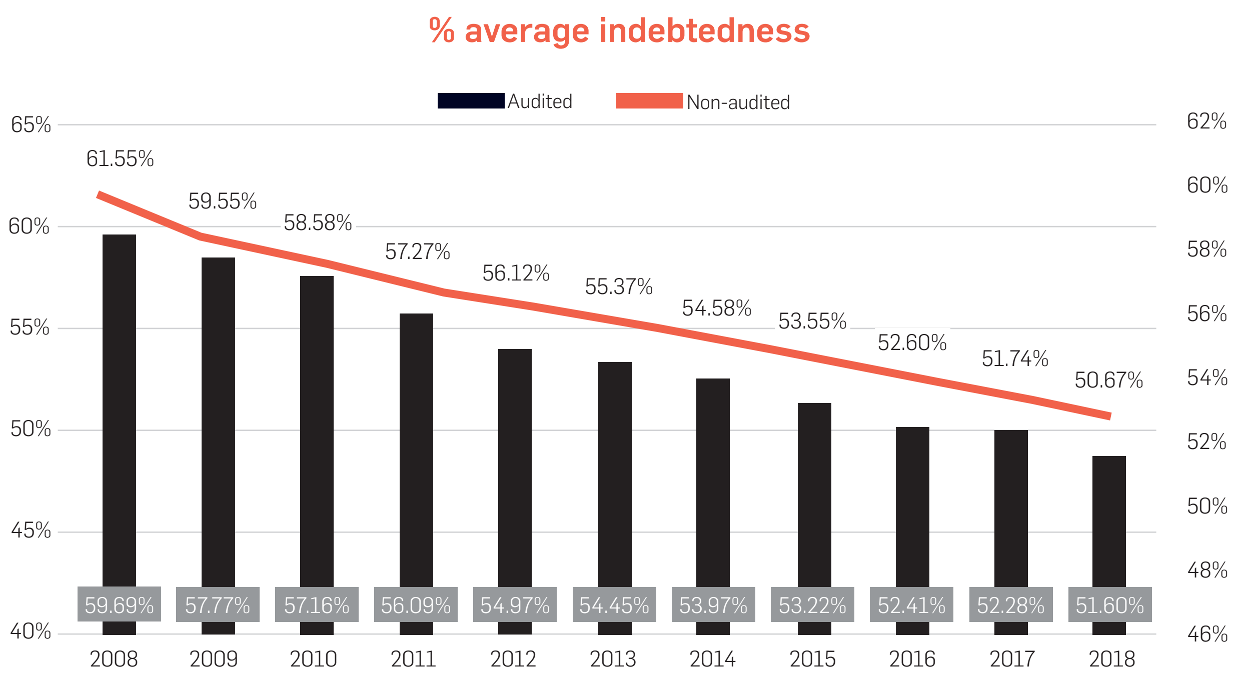
THE AUDITED COMPANIES WITH THE LOWEST AVERAGE DEBT

In the ten years analysed there was a continuous process of generalised deleveraging. The audited companies reduced their indebtedness by 8.09 points, while the non-audited companies reduced it by 10.88 points.

In 2018, the average indebtedness of the audited companies was 59.7%, while that of the non-audited companies was 61.6%, two points higher.

The average indebtedness of the audited companies was lower than that of the non-audited companies for eight of the ten years covered by the study.

In the last two years the situation is reversed, with the average indebtedness of the audited companies being one point higher than that of non-audited companies, due to the lower growth of audited companies' results.



EBITDA

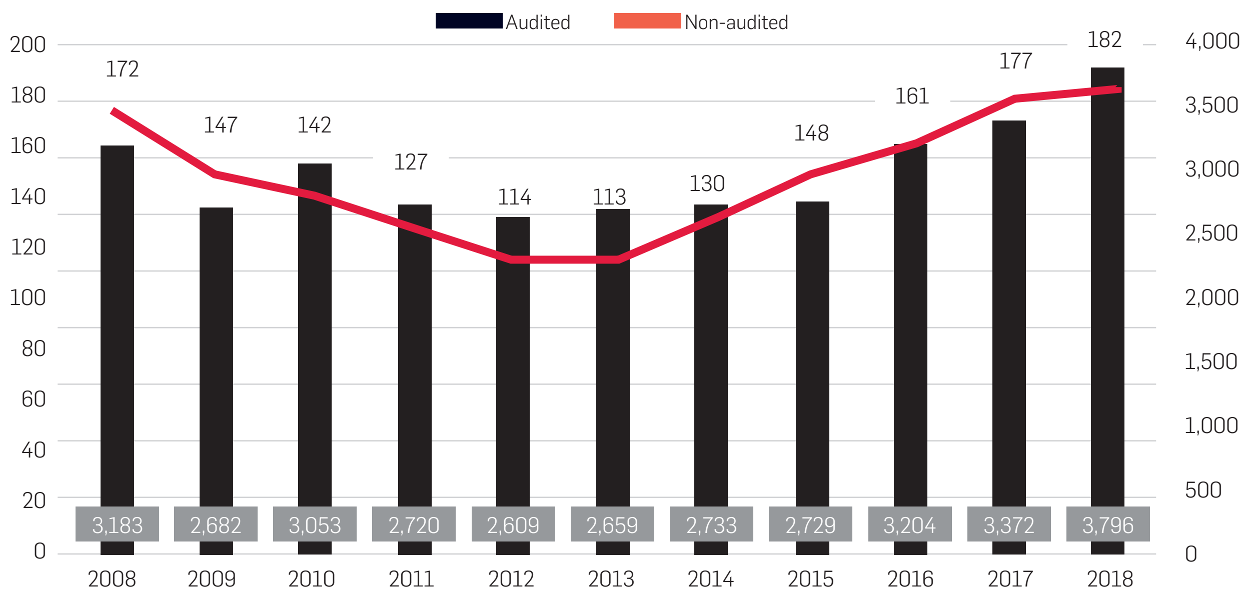
THE AUDITED COMPANIES GREW THREEFOLD IN THE TEN YEARS AND WITHSTOOD THE CRISIS BETTER

The average EBITDA of the audited companies was EUR 3.80 million in 2018, having increased by 19.26% since 2008. In contrast, the non-audited companies had an average EBITDA of 0.18 million euros in 2018, having increased over the ten years by 5.8%. Therefore, the audited companies increased their average EBITDA over the years of the study by three times as much as the non-audited companies.

The average annual rate of change of EBITDA in the period was 2.3% for the audited companies while for the non-audited companies it was 1.1%, the difference in change being more than double.

The average EBITDA had a continuous decline in the initial years between 2008 and 2013, which were the years in which the economic and financial crisis manifested itself with the greatest intensity. This was more pronounced in the non-audited companies (-34.3%) than in the audited companies (-16.46%), even though they had carried out impairment of their assets, which the non-audited companies did not do.

Average EBITDA (1)



(1) Figures in thousands of euros

Profitability (ROA)

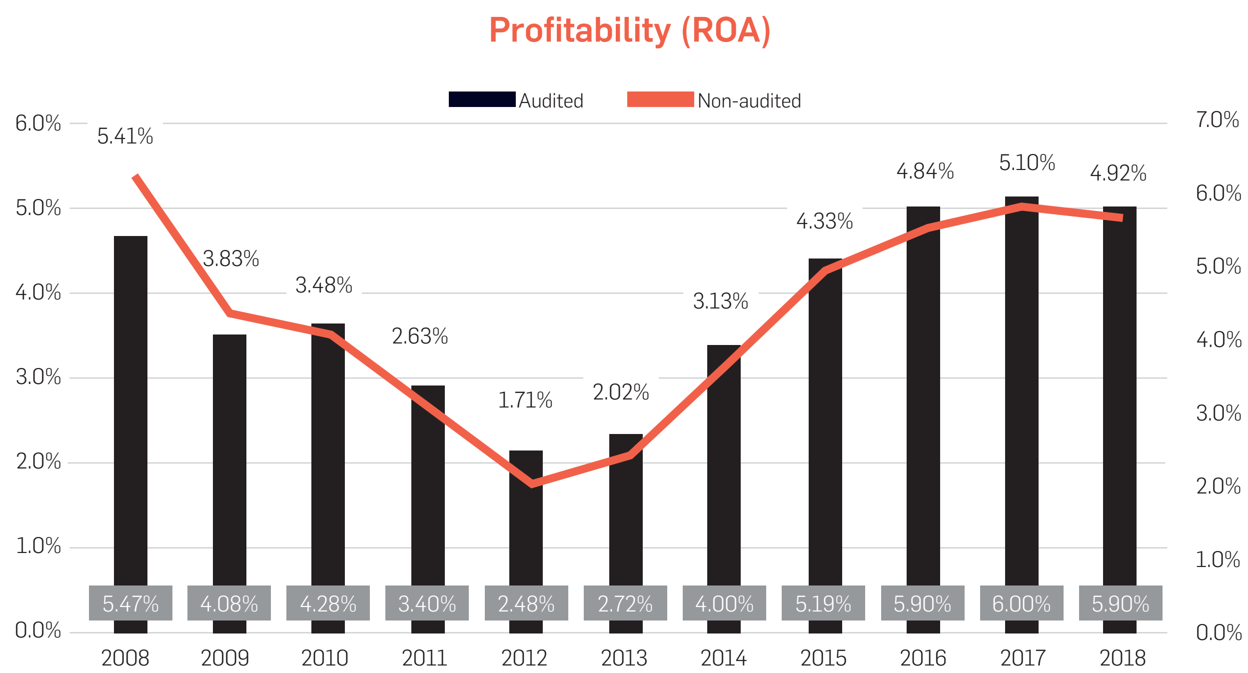
THE AUDITED COMPANIES INCREASED THE PROFITABILITY DIFFERENTIAL BY ONE POINT COMPARED TO THE NON-AUDITED COMPANIES

The average profitability of the audited companies in 2018 was 5.90%, surpassing the profitability that existed in 2008 which was 5.47%, increasing 7.86%. For the non-audited companies, the average profitability in 2018 was 4.92%, which was lower than in 2008 at 5.41%, decreasing by 9.06%.

In the ten years analysed, the difference in profitability between the audited and non-audited companies increased by one point in favour of the audited companies.

In all years, the profitability of the audited companies was higher than that of the non-audited companies.

The audited companies had an average annual profitability of 4.5% over the ten years while for the non-audited companies it was 3.8%, 0.7 percentage points higher for the audited companies.



Can these conclusions be extrapolated to SMEs?

SMEs are an essential source of job and wealth creation for the Spanish economy. For this reason, it is very important to know the effect that the practice of audit can have on their competitiveness and good management, and thus shed light on the debate that is taking place worldwide on the need to make these audits mandatory or otherwise.

Of the 89,568 Spanish companies analysed in the study carried out by the ICJCE, 71,418 met the conditions for micro, small and medium-sized companies, as defined by the European Commission, between 2008 and 2018: turnover of less than 50 million euros, balance sheet total of less than 43 million euros and employees of less than 250.

Of these SMEs, 29.37% audit their annual accounts and 70.63% do not audit them. Of those audited, some do not met the mandatory audit thresholds.

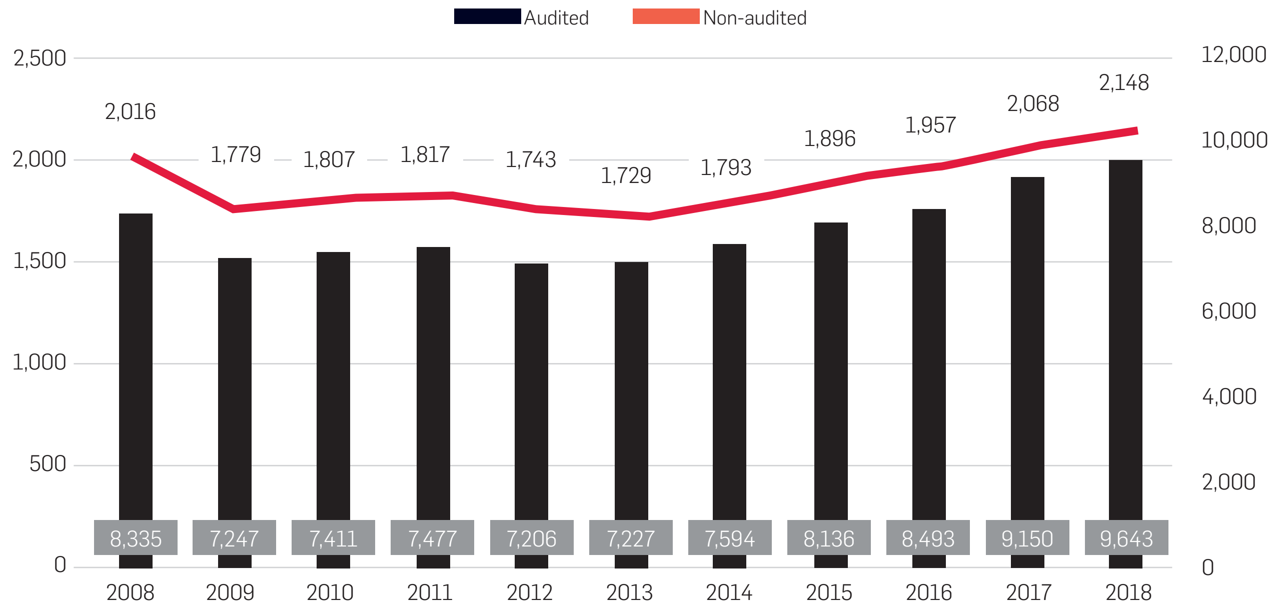
The behaviour of the audited SMEs compared to the non-audited SMEs is analysed below.

SMEs - Net turnover

SALES OF THE AUDITED SMES GREW BY 10 PERCENTAGE POINTS MORE THAN THE NON-AUDITED SMES

The audited SMEs increased their average sales between 2008 and 2018 by 15.69% and the non-audited SMEs by 6.55%, a difference of more than ten percentage points (graph below).

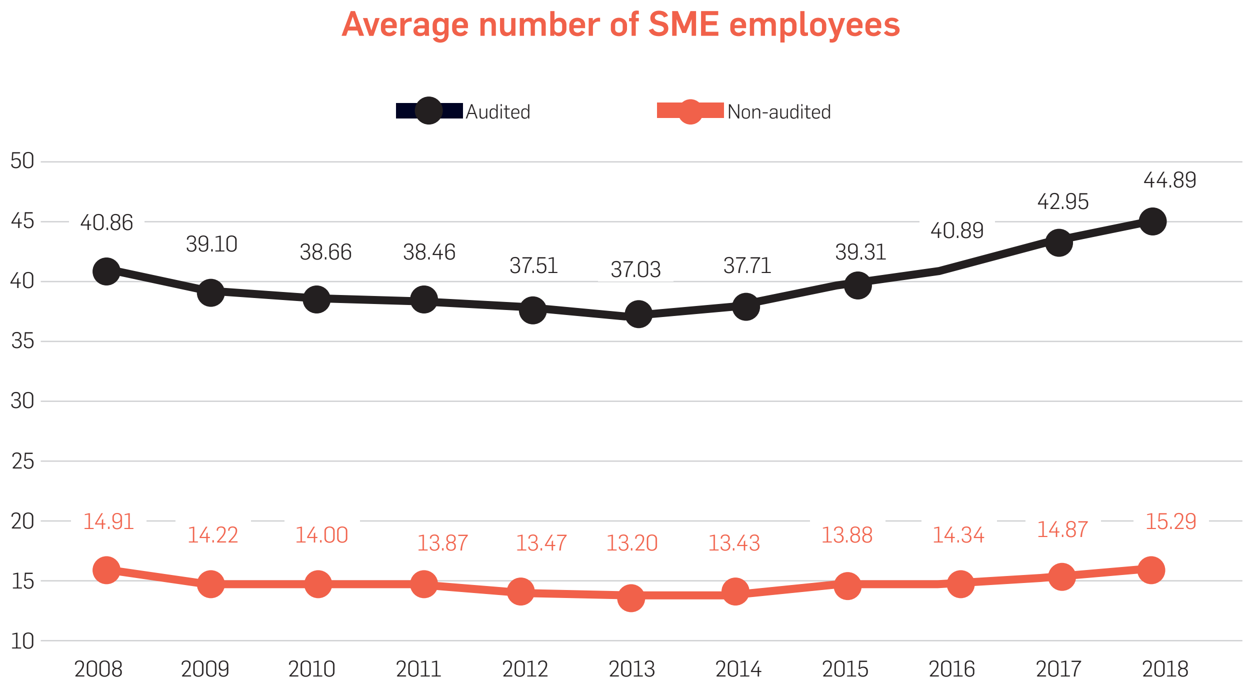
Average SME sales (1)



(1) Thousands of euros

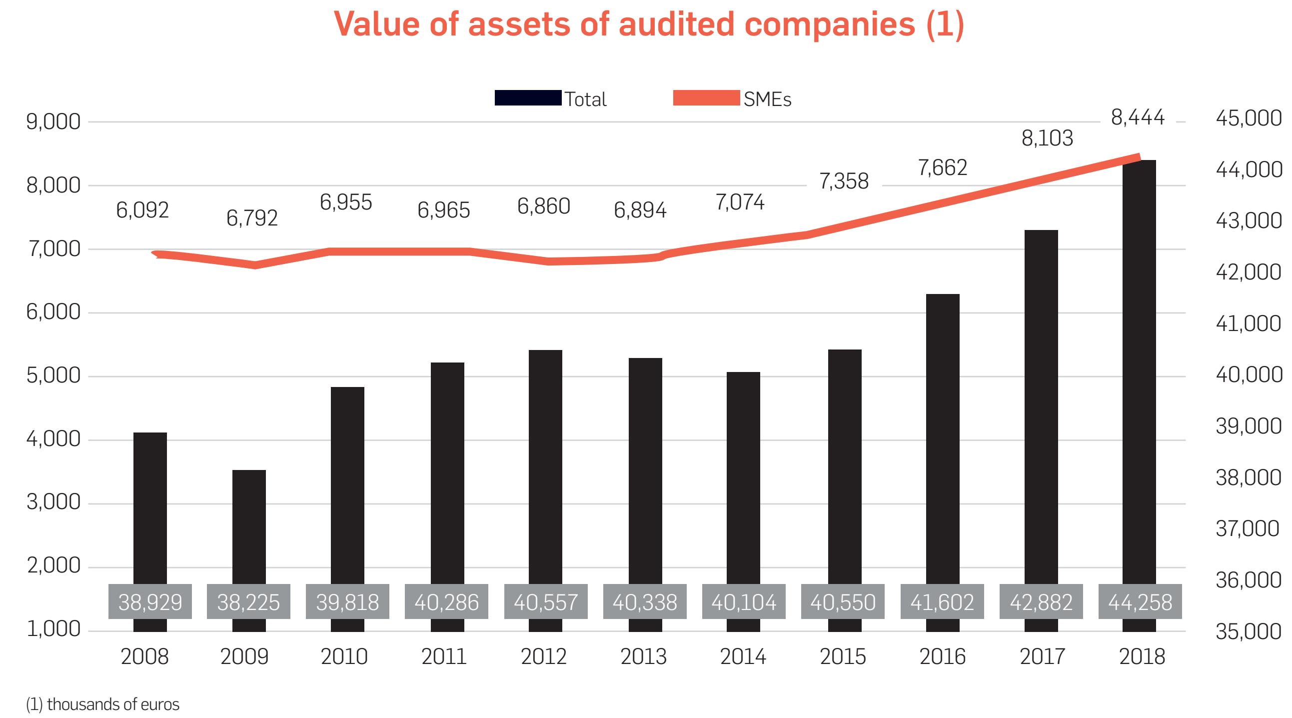
SMEs - Number of employees

The audited SMEs increased their average number of employees between 2008 and 2018 by 9.86% and the non-audited SMEs by 2.68%, a difference of more than seven percentage points (graph below).

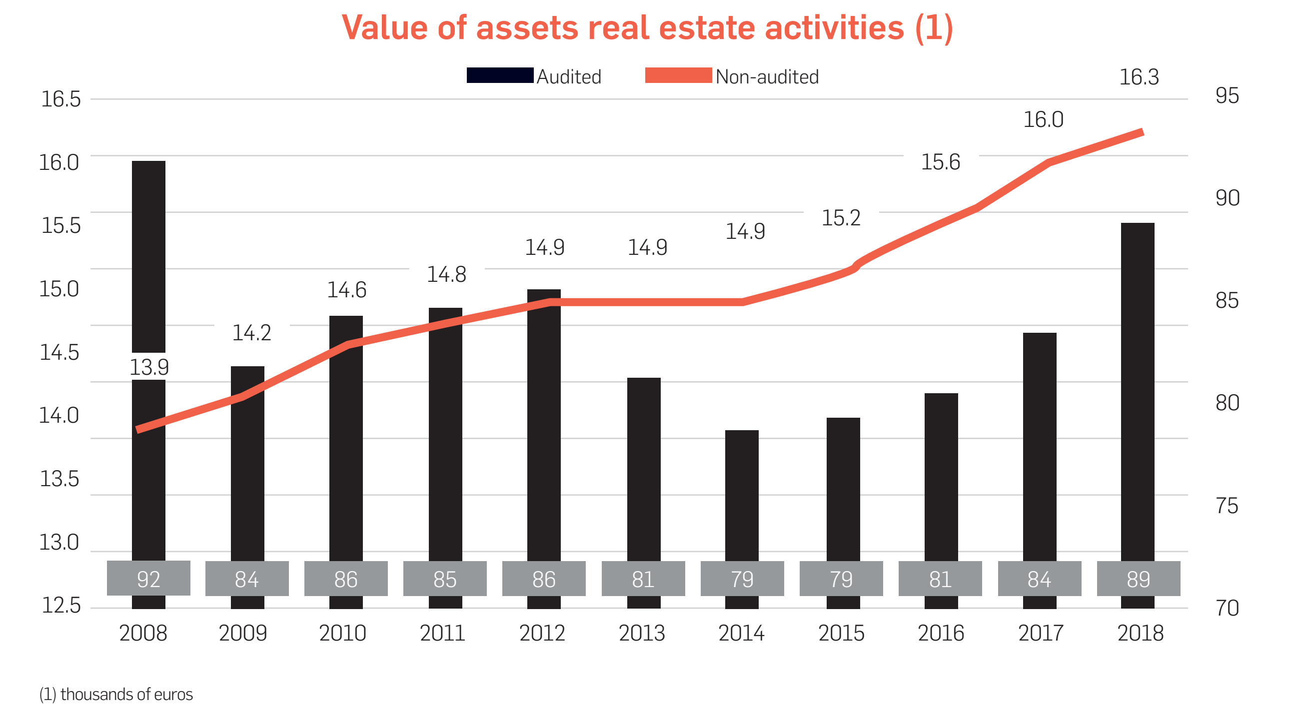


SMEs - Total assets

The assets of the audited SMEs grew less than those of the companies analysed as a whole, due to the write-downs they underwent during the crisis.

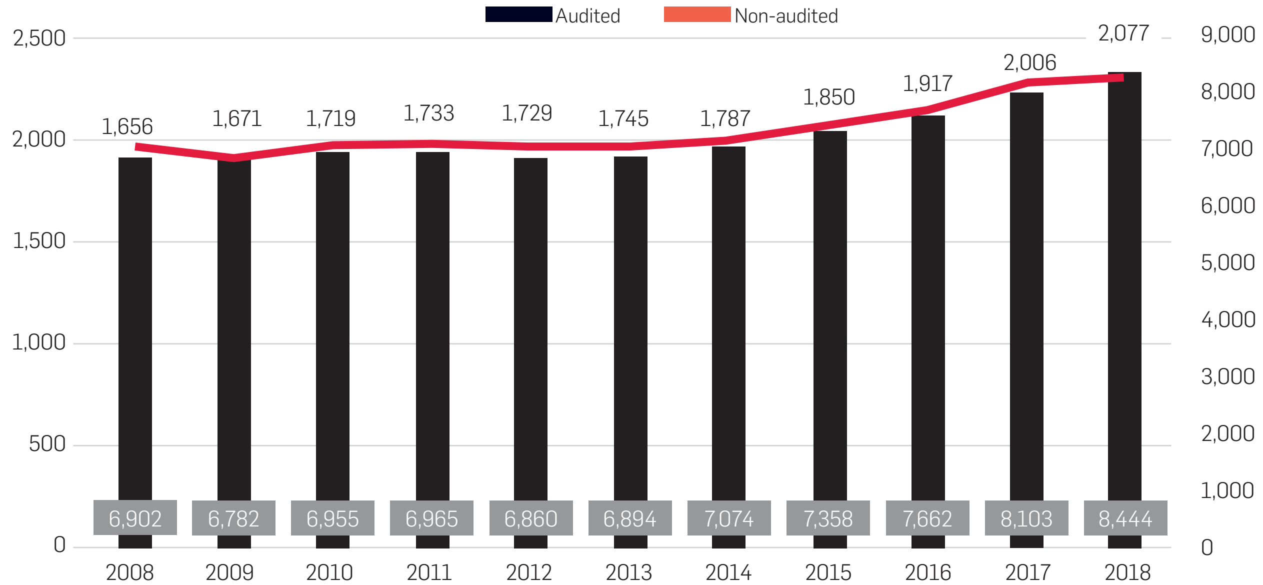


This trend is particularly pronounced in certain periods and sectors. For example, in the real estate sector.



Audited SMEs increased their average assets between 2008 and 2018 by 22.34% and non-audited SMEs by 25.42%, a difference of three percentage points (graph below).

Average asset value of SMEs (1)

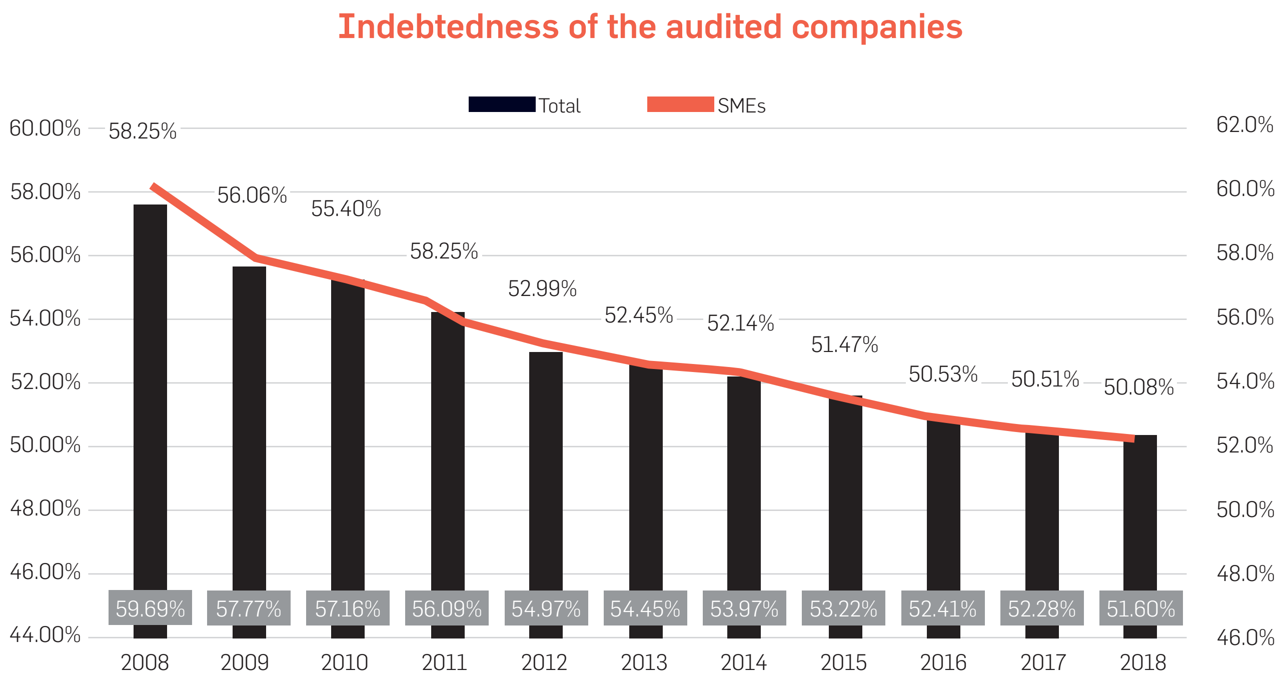


(1) thousands of euros

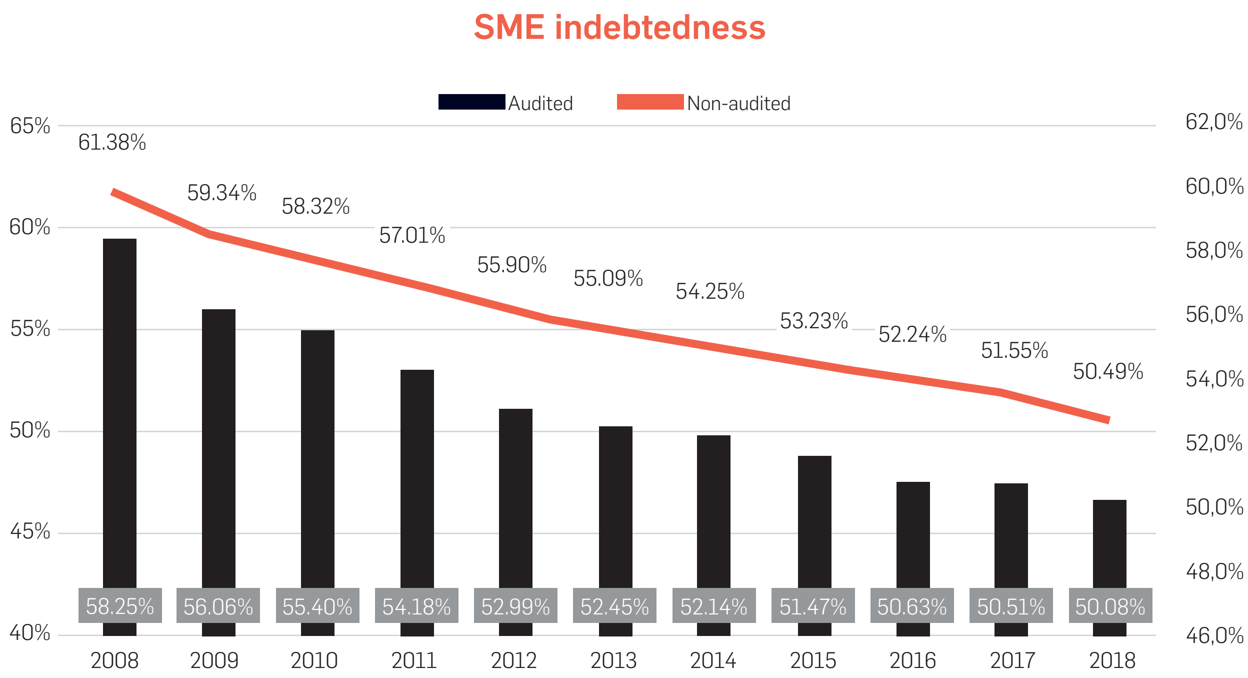
SMEs - Indebtedness

THE AUDITED SMES LESS INDEBTED THAN THE NON-AUDITED SMES

The audited SMEs reduced their average indebtedness between 2008 and 2018 by 8.17 points and the audited companies in the overall survey by 8.09 points, with no differences between them (graph below).



The audited SMEs reduced their average indebtedness between 2008 and 2018 by 8.17 points, and the non-audited SMEs by 10.89 points, 2.73 points more equalling their level in 2018 as their indebtedness was higher in 2008 (graph below).

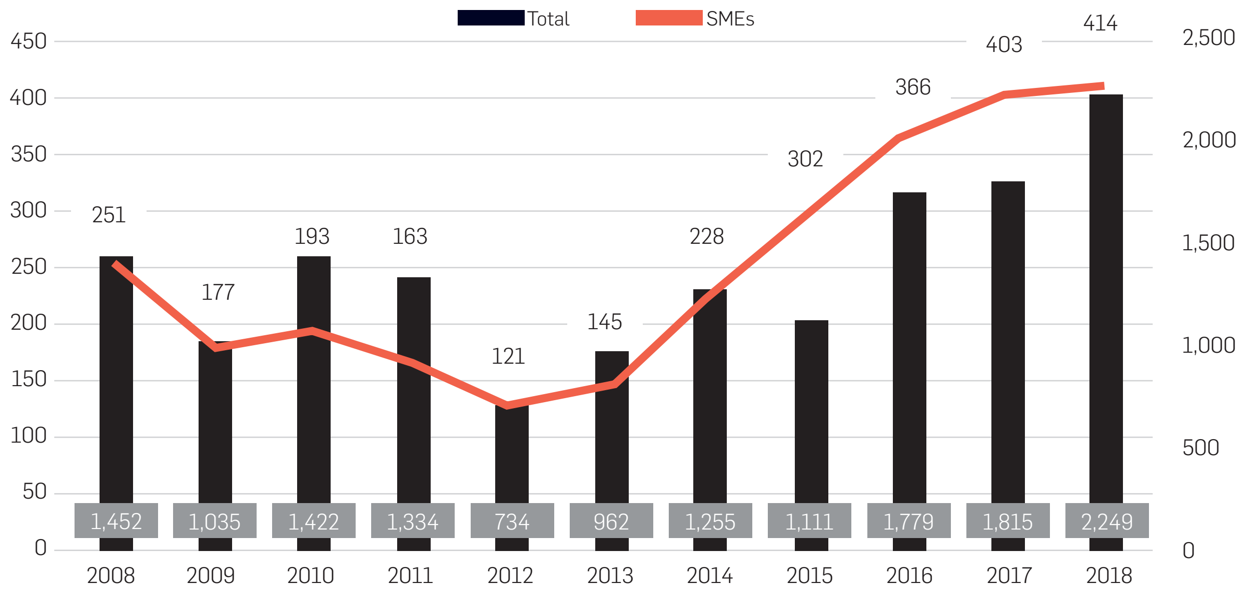


SMEs - Results

THE AUDITED SMES INCREASED THEIR RESULTS MORE THAN THE NON-AUDITED SMES

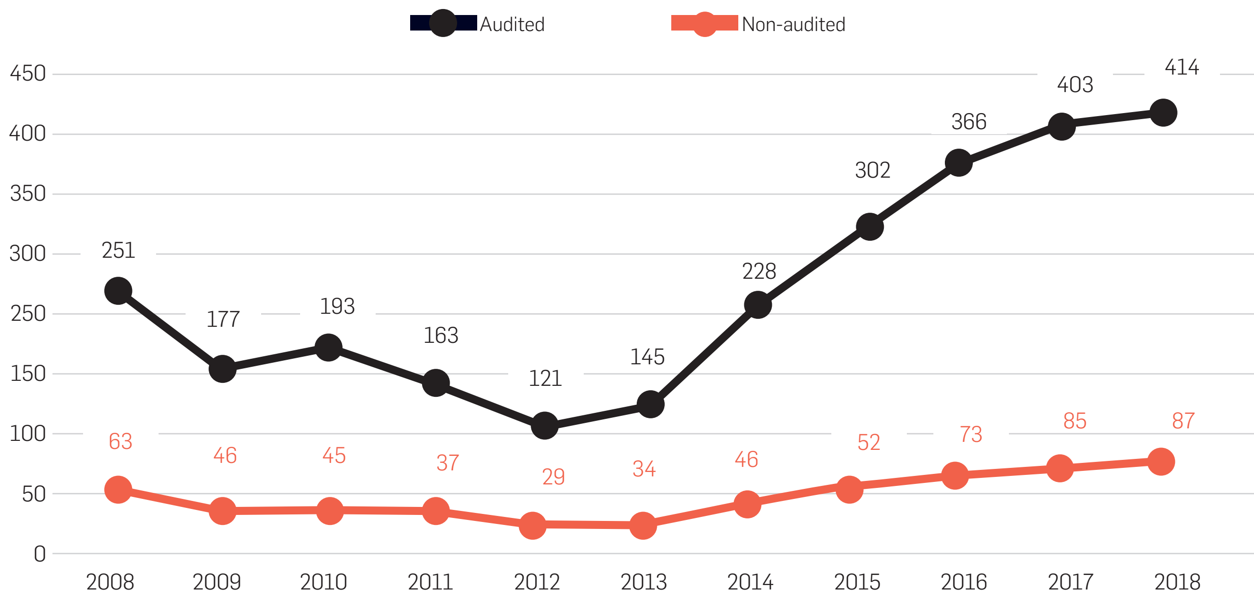
The audited SMEs increased their average results between 2008 and 2018 by 65.20% and the audited companies in the overall study by 54.89%, ten points more in SMEs (graph below).

The audited companies results



The audited SMEs increased their average profits between 2008 and 2018 by 65.20% and the non-audited SMEs by 38%, almost 27 points more in the audited SMEs (graph below).

Average SME profits (1)

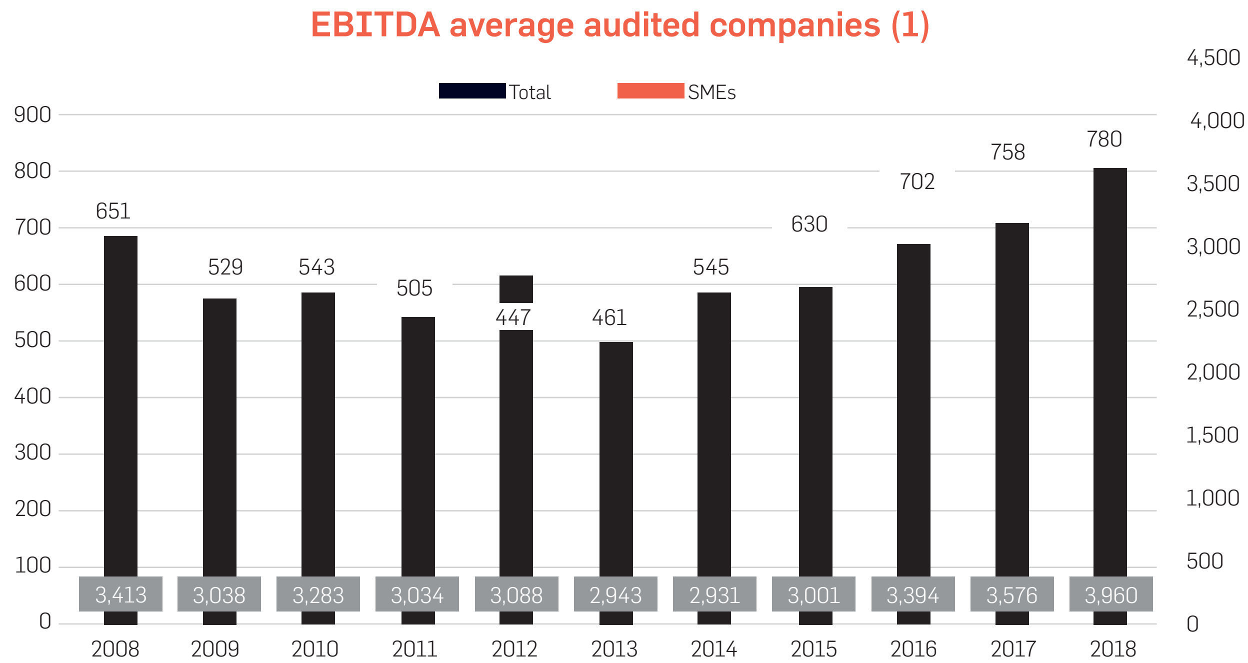


(1) thousands of euros

SMEs - EBITDA

THE AUDITED SMES INCREASED THEIR EBITDA 14 TIMES MORE THAN THE NON-AUDITED SMES

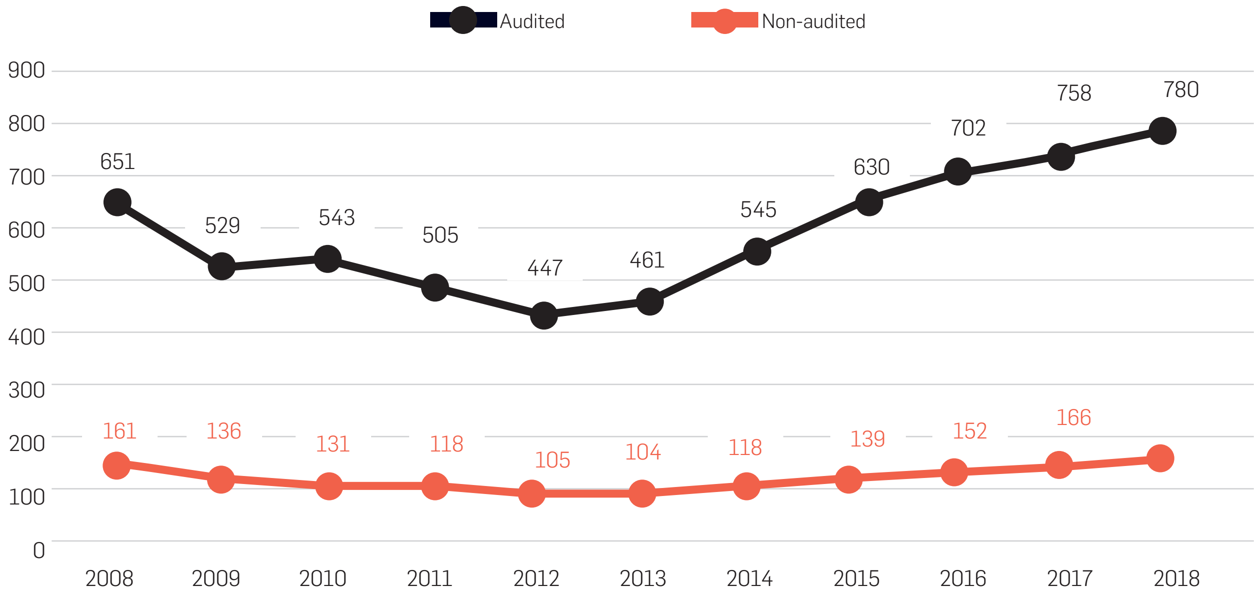
The audited SMEs increased their average EBITDA between 2008 and 2018 by 19.8% and the audited companies in the overall study by 19.26%, with virtually no difference between them (graph below).



(1) thousands of euros

The audited SMEs increased their average EBITDA between 2008 and 2018 by 19.8% and the non-audited SMEs by 5.7%, almost 14 points more in the audited SMEs (chart below).

Average SME EBITDA (1)



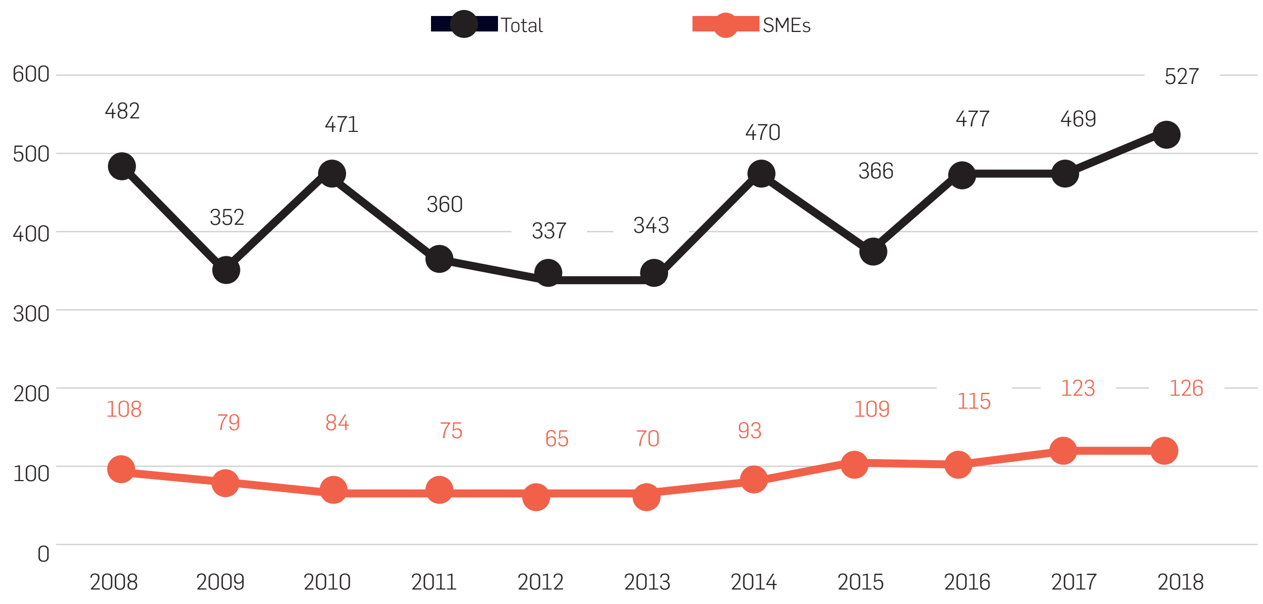
(1) thousands of euros

SMEs - Corporate income tax

THE AUDITED SMES INCREASED THEIR CORPORATE TAX EXPENSE LESS THAN THE NON-AUDITED SMES

The non-audited SMEs increased their average corporate tax expense between 2008 and 2018 by 16.7% and the audited companies in the overall survey by 9.3%. This was seven points higher in the SMEs (graph below).

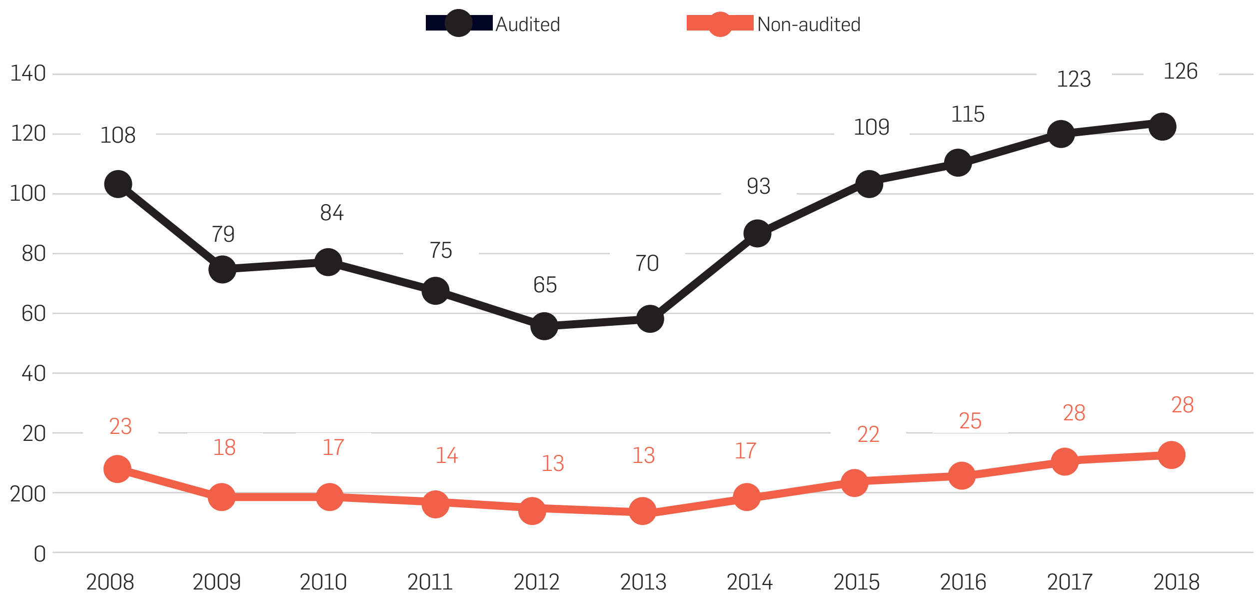
Corporate income tax paid by the audited companies (1)



(1) thousands of euros

The audited SMEs increased their average corporate tax expense between 2008 and 2018 by 16.7% and the non-audited SMEs by 21.74%, five points more in the non-audited SMEs (graph below).

Corporate income tax paid by SMEs on average (1)

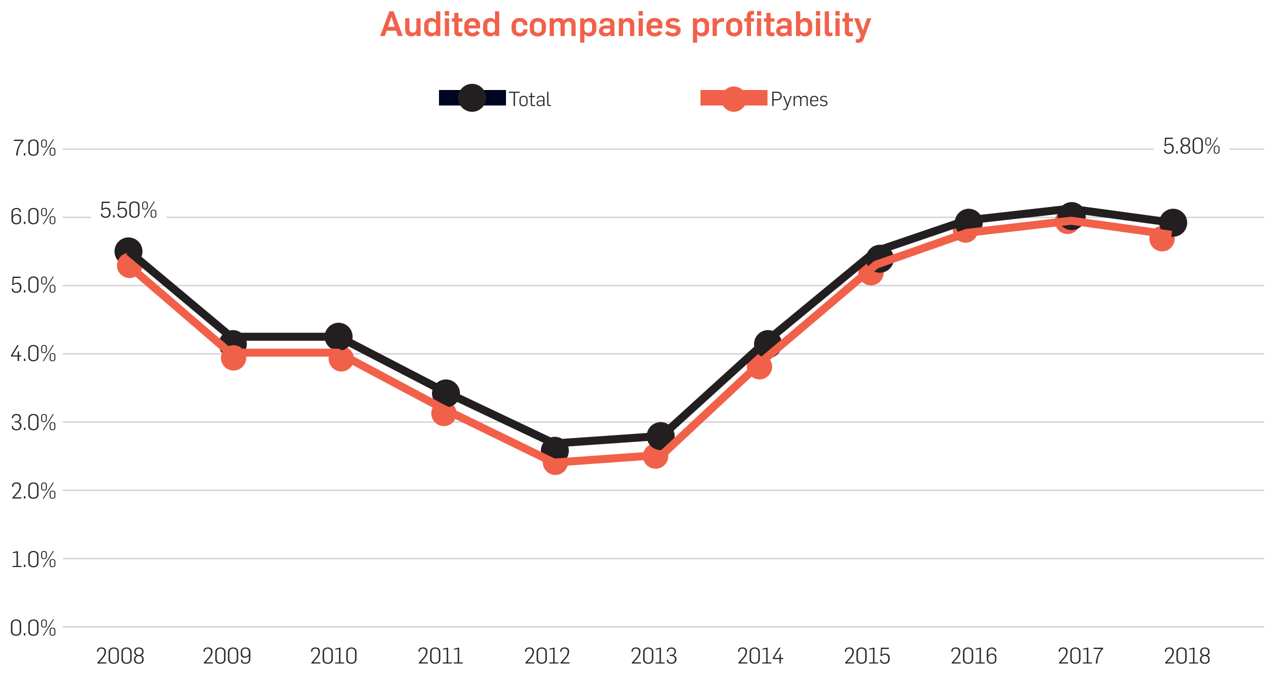


(1) thousands of euros

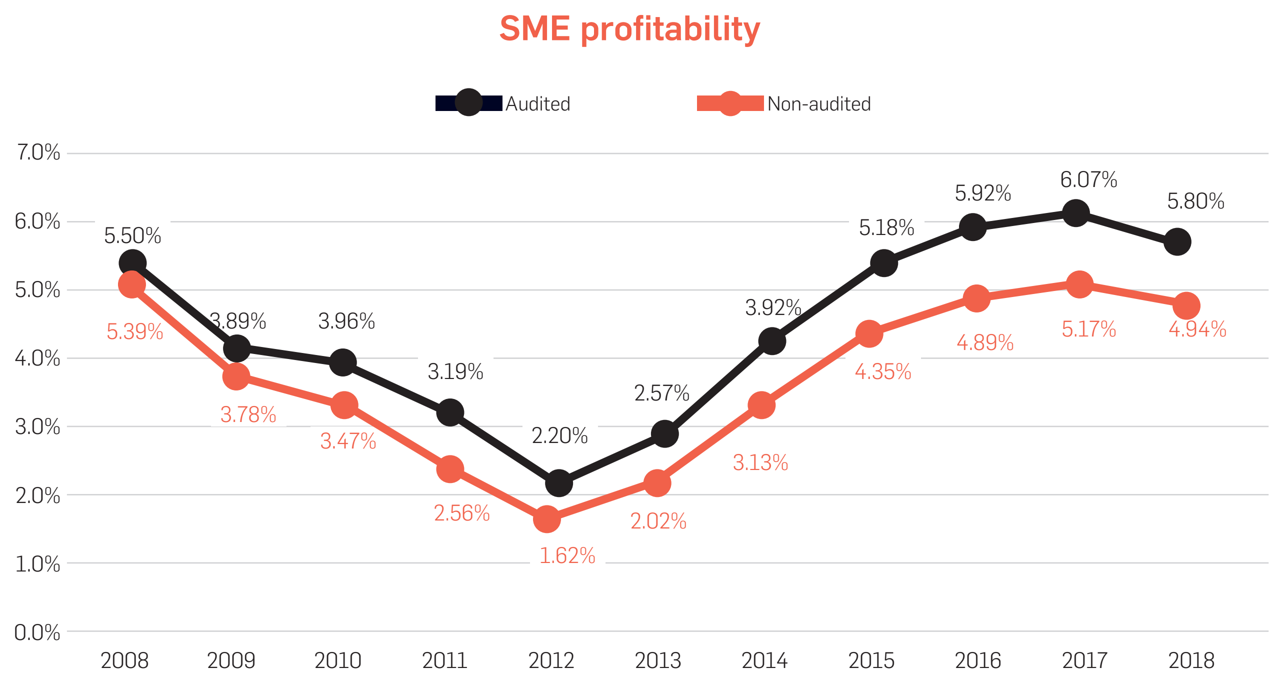
SMEs - Profitability (ROA)

THE AUDITED SMES INCREASED THEIR PROFITABILITY MORE THAN THE NON-AUDITED SMES

The profitability (ROA) of the audited SMEs and the audited companies in the overall study was almost identical between 2008 and 2018 (bottom chart).



The audited and non-audited SMEs had an even profitability in 2008 and 2009, but from that year onwards the audited SMEs had a higher average profitability (bottom chart).



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