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Assessment on the impact of provision of non-audit service on auditor independence: A case of Masvingo Province

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Abstract:
The main aim of this study is to evaluate the extent to which non audit services impair external auditors' independence in Masvingo town. A quantitative research design was used in this study. The sample of 70 participants was used in the study. Data was collected using questionnaires from the partners, auditors, and senior management in Masvingo. Results of the study indicated that self-interests and familiarity were the major threats affecting auditors. Findings also indicated that auditor independence with non-audit services cannot be maintained. . The study concludes that non audit services could be extended in Masvingo, with exception of non-audit services with proven risk to auditor independence. The nature of non-audit services should be clear and pre-approved by the client, and non-audit fees published Keywords:;auditing; audit clients; audit firms., Auditor independence, Non audit services

1. Introduction

Raffa (2003) defines auditing as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree correspondence between those assertions and established criteria and communicating the results to interested users. On the other hand, Dicksee (1905) used the word auditing as an examination of accounting records undertaken with a view to establishment whether they correctly and completely reflect the transactions to which they purport to relate. Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports (Mautz,200). According to Schlosser "Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirement." From the above definitions, it can be concluded that the auditor should be objective in all this processes. Therefore, it is fundamentally important for the external auditor to act with an independent mind and in good faith while conducting audit work.

In a competitive world that we are in today, external auditors now have an additional responsibility to provide non audit services other than auditing. These non-audit services according to Cosserat (2004) include identifying business risk and providing guidance on internal control weaknesses. With the recent corporate failures around the world such as Enron, this has heated up the issues related to auditor independence and questioned their integrity, objectivity, and independence (Yang et al, 2003). This has brought many governments around the world to revisit their auditor independence regulation and professional bodies to develop new codes of ethics. Therefore, corporate failures are the common problem for countries around the world which are forcing regulators to make legislative changes.

The provisions of non-audit services by audit firms to their clients is popular in the current market and has brought continuous debate over the independence of auditors. Non audit services include consulting services such as system design, compliance related services, taxation, bookkeeping, or any other services that relates to accounting records or financial statements of the audit client, financial information system and implementation, actuarial service, internal audit outsourcing services, management functions or human resources, dealer, and investment advisor.

The fees generated by the non-audit services have been rising more rapidly than the audit fees. This has been worrying as many such institutions have collapsed in the presence of such auditors. This led to the widespread beliefs that provision of non-audit services can cause auditors to compromise their independence. There are two main concerns which auditors may not stand to management because they wish to retain the additional income from non-audit services which is the management’s gift and secondly provision of service to management may lead the auditor to identify too closely with management and lose skepticism.

According to Ojo (2009) the provision of non-audit services does not necessarily influence the independence of auditors. However, where the fees are generated from such non audit services are considerably high as compared to the audit fees earned by the audit firm, there arise a problem. This creates a situation where auditor’s independence is compromised. If the auditor decides to give a qualified opinion on the financial statement being audited in such a situation, the auditor may be denied lucrative contracts in non-audit services.

In Zimbabwe, many corporates including banks, and parastatals (National Railways of Zimbabwe and Air Zimbabwe) have been affected by failing to comply with corporate governance framework of non-audit services and the audit committees. According to Mutisi (2020) the board members are to be blamed for these corporate failures. Some board members of these corporates have their terms long expired and as a result there is no strong audit committee which is objective.

As auditors now have additional responsibility of the provision of non-audit services, there is a great concern about propriety, especially issues related to the auditor’s independence (Lowe and Pany, 1995). There are quite a number of threats that can impair the independence of auditors while they are providing non audit services namely: self-interest, self-review, advocacy, familiarity, and intimidation threats. Because of these available threats, the researcher would like to assess the impact of the provision of non-audit services to audit clients.

1.2 Research objectives

The main objective of this study is to assess whether providing non audit services to audit clients will impair auditor independence. The sub objectives are:

- To determine the threats to auditors from selected firms in Masvingo urban
- To assess the extent to which audit committee must approve all permitted non audit services to be provided by the auditor before services are provided.

To examine the extent to which audit firms should have certain procedures and suitable measures to maintain their independence

1.3 Literature review

Provision of non-audit services may pose a real threat to auditor’s independence in the case of the audit client. The principal threats that may arise from provision of non-audit services are:

Self-interest threat: according to International Standards Board (ISB) (2000) self-interest threat occurs when auditors act in their own interest in preference to performing a quality audit. Self-interest can be financial, emotional or any type of personal interest. The international Federation of Accountants (IFAC) identifies circumstances under which self-interest situations occur (IFAC handbook, 2006, p43).

- a direct financial interest or material indirect financial interest in an assurance client
- a loan and a guarantee to or from an assurance client or any of its directors or officers
- undue dependence on total fees from an assurance client
- concern about the possibility of losing the engagement

- having a close business relationship with an assurance client
- potential employment with an assurance client
- contingent fees relating to assurance engagements

With the current economic situation in our country, there is a high possibility that the above situations that involve financial interest can be a great threat to auditors in Masvingo. Also because of high competition amongst the audit firms, there is a high probability that audit firms highly dependent on audit clients. Therefore, the researcher would like to assess the relationship of the auditors with their clients especially the issue of their audit tenure.

Self-review threat: ISB, (2000) para 12b, illustrates and defines the self-review threat as when auditors review judgements and decisions they, or others in their firms have made. Auditors that provide other non-audit services such as bookkeeping for the audit client impairs auditor independence. self-review threat exists if the results of non-audit services performed by the audit team, or by others within the audit firm, are reflected in amounts included or disclosed in the financial statements. In this study, the researcher would like to investigate if audit firms that provides non audit services to audit clients in Masvingo are affected with this threat.

Advocacy threat: this is a situation when auditors or others in their audit firm promote or advocate for or against an auditee's position or opinion rather than serving as unbiased attestor of the auditees' financial information (ISB, 2000, para.12c). Others consider that, because auditors only provide advisory services, they are not involved in the client's decision-making processes and their independence is not compromised. Brody and Masselli (2000) argue that auditors often act for the benefit of their clients, especially in situations where the law is ambiguous, which may reduce auditors' objectivity. In Masvingo there are few audit firms and there is a possibility that they might find themselves in providing advocacy services for their clients.

Familiarity threat: the familiarity threat arises when an auditor is not sufficiently removed from the client's affirmations and is influenced by the management or even the board (ISB, 2000). According to IFAC handbook 2006 familiarity threats occurs when,

Long association of a senior member of the assurance team with the assurance client an auditor has a particularly close or long-standing relationship with a client, its directors, officers, or employees.

- A member of the assurance team having an immediate family member close family member who is a director or officer of the assurance client.
- A member of the assurance team having an immediate family member or close family member who, as an employee of the assurance client, is in position to exert direct and significant influence over the subject matter of the assurance engagement.
- A former partner of the firm being a director, officer of the assurance client or an employee in a position to exert direct and significant influence over the subject matter or the assurance engagement.
- Acceptance of gifts or hospitality, unless the value is clearly insignificant, from the assurance client.

With the above situations, familiarity threat can be created and in a city like Masvingo which is so small, auditors and clients can have a personal relationship. So, the researcher would like to find out if familiarity threat is a threat to auditor independence.

Safeguards against threats to auditor independence

According to Allen and Siegel, (2002) they proposed the following safeguards:

Absolute prohibition: where auditors are barred from having any direct financial investment in any audit clients' companies as this will cause a self-interest threat to the auditors.

Restricting the extent of relationship between the auditor and the client but requiring other policies or procedures that eliminate or mitigate the threat for example, the mandatory replacement of an engagement partner after the partner has spent a certain period of time on a specific audit engagement to mitigate a familiarity threat.
They also suggested that the auditor should also disclose information about the relationship to the audited client's management, audit committee, board, or others—for example, disclosure to an auditee's audit committee of the nature of all services provided by the auditor to the auditee and the fees received for such services
The International Organization of Securities Commissions (2002) suggested that the governance structure of an entity can play an important role in monitoring and safeguarding the independence of its external auditor. The exact form of an entity's governance structure and the roles that any individual governance bodies perform in relation to the external auditor may vary depending on the requirements of national laws. They went on to say that the audit committee should on a regular and frequent basis meet with the auditor without management present and discuss with the auditor any contentious issues that have arisen with management during the course of the audit and whether they have been resolved to the auditor's satisfaction. They suggested that when the board is selecting an auditor to recommend for appointment or reappointment, the audit committee should satisfy itself that the auditor is independent in accordance with applicable standards.

Mutisi, (2020) noted that the same board members are to be blamed for company failures. He states that the biggest problem that leads to the collapse of companies in Zimbabwe is the independence of the board of directors. It has been noted that most board members and directors of Zimbabwean companies are invited to join the board by the CEO. This is mostly based on their relationship that included business ties, friends, or family members of the CEO. These kinds of directors will always support the CEO in adopting policies that entrench the CEO like salary and increases of allowances which has been the major cause of all company closures. Mutisi (2020) went on to say that companies that offer board members unlimited fuel, goods, and services they produce for free, foreign trips and other benefits whether a company is in dire straits or not this affects the bottom line of the company. The is need for independence from the board members to the auditors themselves.

2. Research Method

In this research, the researcher used the quantitative research design. In the context of this research, participants were selected from ten audit firms in Zimbabwe. For the purposes of this study, the researcher used random sampling techniques to select a sample of audit firms. For auditors and senior managers, the researcher used stratified sampling technique. In this study, a sample of 10 partners, 30 auditors and 30 senior managers was selected. Therefore, participants included auditors, senior managers, and partners in audit firms in Masvingo. Questionnaires were used as a quantitative method for a larger population. Data which was collected from the questionnaires included threats which affected auditors, extent to which the audit committee must approve all permitted non audit services to be provided by the auditor, procedures, and measures which auditor independence. Thus, a total of 70 questionnaires were distributed and 43 were returned and fully completed. Therefore a 61% return rate was achieved in the study.

3. Results and Analysis

Threats affecting auditors

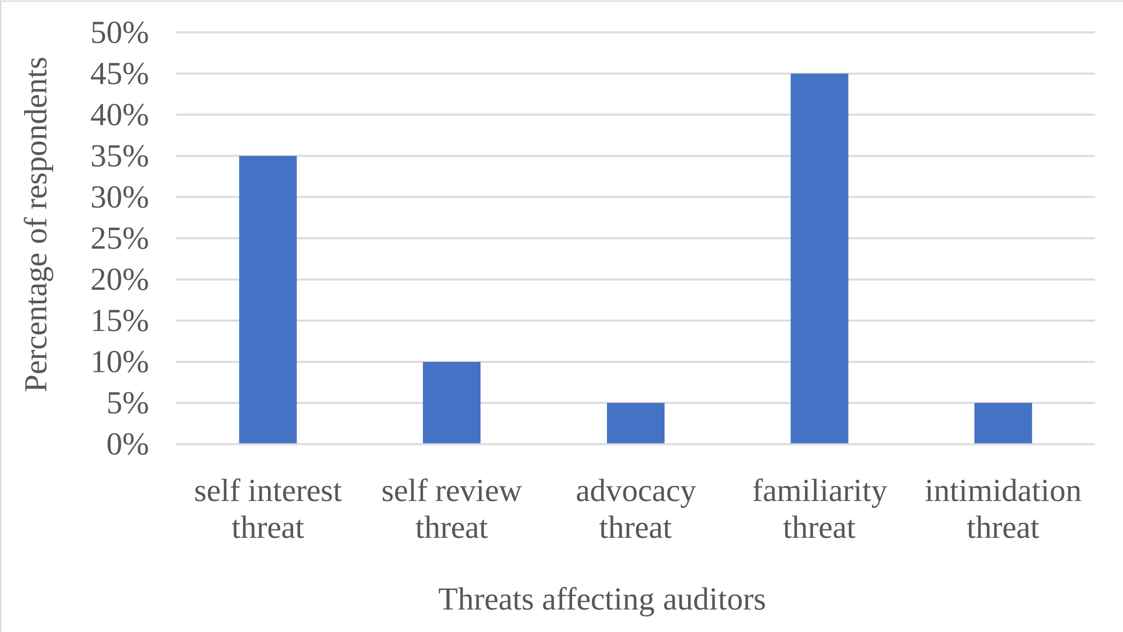

Figure 1. Threats affecting auditors

Results presented in Figure 1 show that 45% of the respondents identified familiarity threat as a threat that affects auditors' independence in Masvingo. Findings also indicated that the other threat was in the form of self-interest (35%) which affected the auditors from the selected firms in Masvingo urban. There were other threats which were not indicated by more respondents and these included self-review (10%), advocacy (5%) and intimidation. Most of the threats tend to happen since Masvingo is a small town, and it has a few audit firms and most of the business people know each other very well on a personal level. This affects the independence of the auditor thereby affecting the quality of the audit carried out. Results of the study are in line with Allen and Siegel, (2002) who indicated that the auditor should also disclose information about the relationship to the audited client's management, audit committee, board, or others. The study also found out that self-interest was a threat but most respondents were not open as to how this the auditors have the self-interest. This has been supported by Allen and Siegel, (2002) that the auditors should be prohibited from having any direct financial investment in any audit clients' companies as this will cause a self-interest threat to the auditors. Few of the respondents identified self-review threat as a threat to auditor independence in Masvingo because audit firms practice is audit rotation when carrying out their work.

Audit committee must approve all permitted non audit services to be provided by the auditor before services are provided.

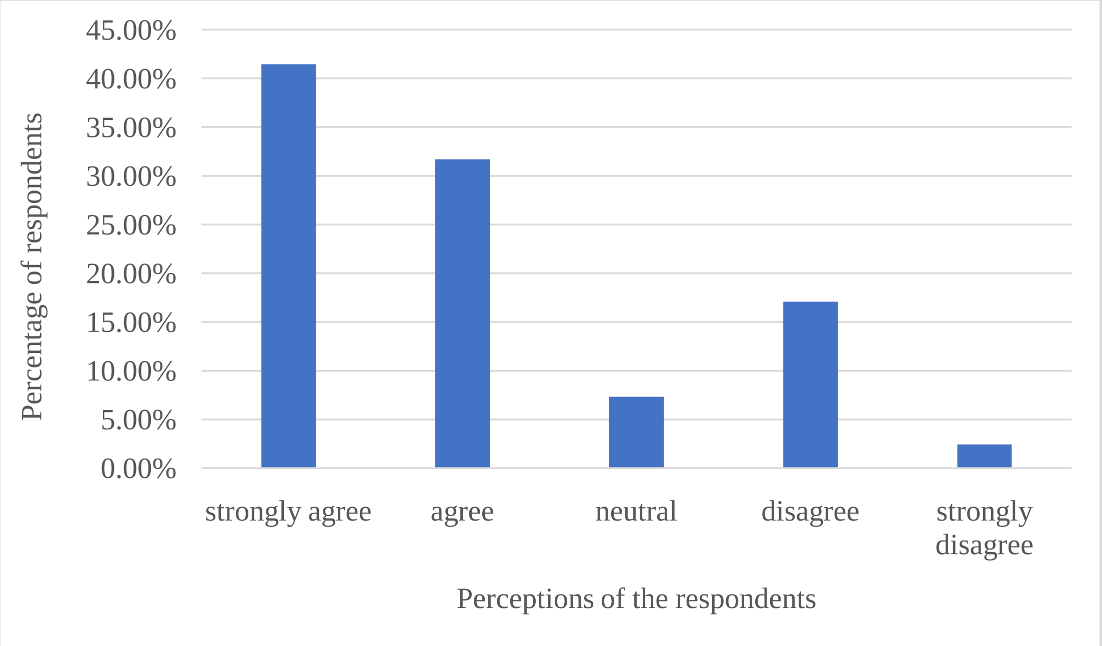

Figure 2: Perceptions on view that audit committee must approve all permitted non audit services to be provided by the auditor before services are provided.

Results which are presented in Figure 2 show that 40% of the participants strongly agreed whilst 33% of the participants just agreed with the view that audit committee must approve all permitted non audit services to be provided by the auditor before services are provided. Thus overall, it can be noted that a total of 73% of the participants which includes auditors, senior managers and partners of the audit firms agreed with the view that audit committee must approve all permitted non audit services to be provided by the auditor before services are provided. Results also show that there were 8% of the participants who were neutral on their view towards the provision of non-audit services. About 19% of the participants disagreed with the view that audit committee must approve all permitted non audit services to be provided by the auditor before services are provided. From the findings in Figure 2, these results suggest that prior approval of non-audit services by the audit committee is a safeguard to auditor independence. It enhances the credibility of the financial statements by enhancing auditor independence. This is supported by International Organization of Securities Commissions (2002) that the audit committee should be involved and should make sure that the auditors are independent before they are engaged.

Audit firms should have certain procedures and suitable measures to maintain their independence

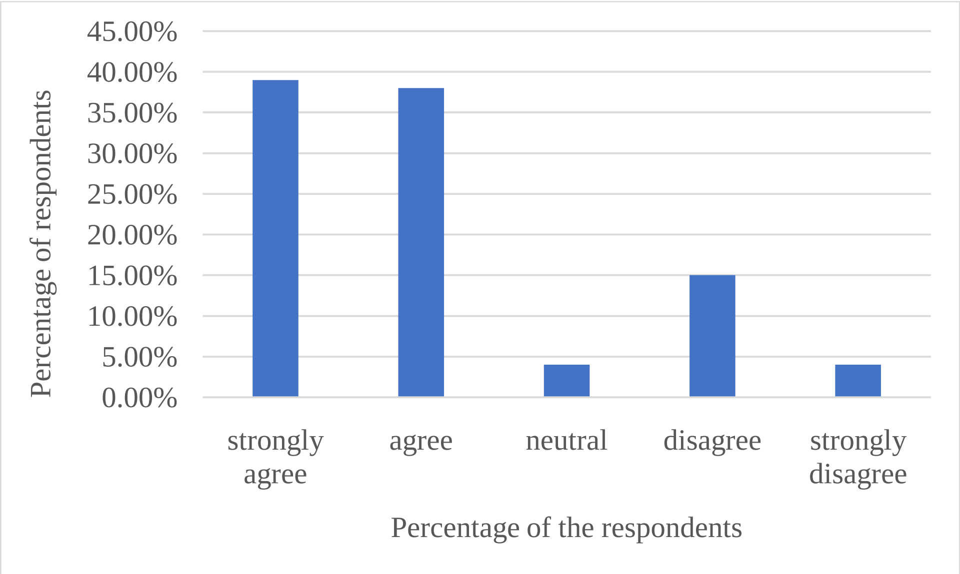

Figure 3. Audit firms should have certain procedures and suitable measures to maintain their independence

Results which are presented show that 39% of the participants strongly agreed with the view that audit firms should have certain procedures and suitable measures to maintain their independence. About 37% of the participants also agreed with the view that audit firms should have certain procedures and suitable measures to maintain their independence Thus when combined 76% of the participants agreed with the view that audit firms should have certain procedures and suitable measures to maintain their independence this statement. These results suggest that audit firms should have policies and procedures in place to ensure the independence of firm members, as a safeguard to auditor independence. However, the remainder of the participants were neutral, disagreed and strongly disagreed with the view that audit firms should have certain procedures and suitable measures to maintain their independence.

Public companies should not offer jobs to their external auditor or their personnel

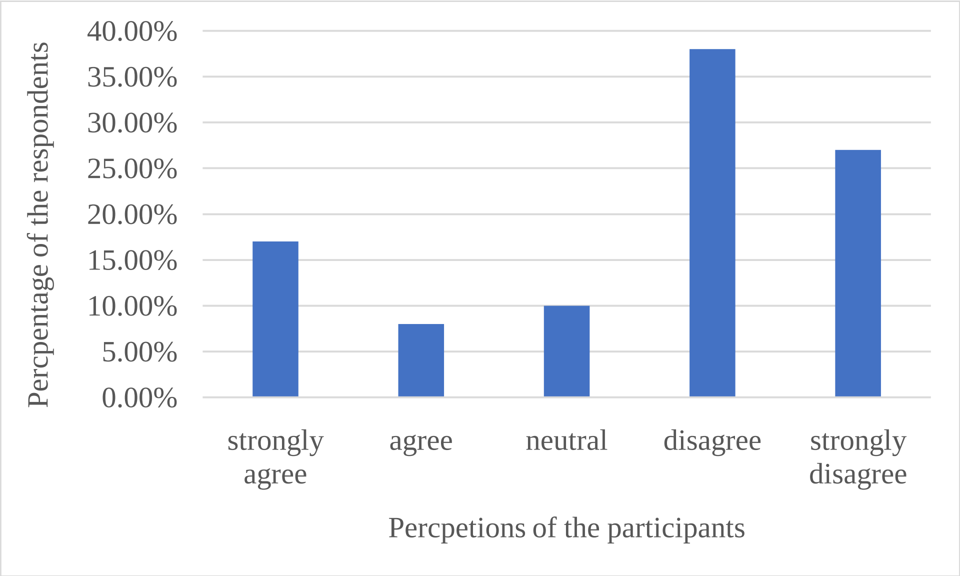

Figure 4 Public companies should not offer jobs to their external auditor or their personnel

Results of the study show that 17% of the respondents strongly agreed that public companies should not offer jobs to their external auditor or their personnel. Seven percent also agreed that public companies should not offer jobs to their external auditor or their personnel. Ten percent of the participants were neutral on the view that public companies should not offer jobs to their external auditor or their personnel. Figure 4 shows that, the majority (62% of the participanst) disagreed with this statement due to the advantage that maybe gained by audit firm staff being employed by audit clients. It is believed that employment of a firm's auditors by a client may impair auditor independence (Citron, 2003). Executives are found to be affiliated with their companies' audit firms if they previously worked for those audit firms.

4. Conclusion (10pt)

The study concludes that familiarity and self-interests were the major threats to auditor independence for the selected firms in Masvingo urban. The study concludes that the audit committee must approve all permitted non audit services to be provided by the auditor before services are provided. This will allow the independence of the auditor which is a fundamental issue to the reliability of auditor's reports and critical to acceptance of financial statements as the basis of decisions. The study also concludes that auditors cannot maintain independence while providing non audit services to audit clients. Few of the respondents did approve that auditors can maintain independence; this response relates to the fact that auditors rely on income generated from non-audit services more than their audit services. It can be concluded that auditor independence would safeguard if auditors were to provide full disclosure in companies accounts following the provision of non-audit services. Disclosure could inform shareholders and regulators about auditor relationship with the company. The results might suggest that the users aware of the level of relationship between auditors and clients' management and could question both parties on any issues about which they need further clarification during the annual general meeting.

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