A Study of Independence:
"Auditors as a Necessary Evil"

Colin Millar Dempster

Dissertation Advisor: Dr. Katarzyna Kosmala MacLullich

Word Count: 15,000

Dissertation submitted in partial fulfilment
of the degree of MA(Hons) in
Accountancy & Finance

at

The School of Management and Languages
Department of Accountancy and Finance,
Heriot-Watt University,
Edinburgh.

April 2003

"It was not that independence of auditors was not required, but in the more gentlemanly days of yesteryear it was never in doubt"

Morrison (1977)

cited by Ansong et al. (2000)

"Because of audit's high public profile, it is on the performance of auditors that our profession will often be judged"

Plaistowe (1992)

cited by Sikka & Willmott (1995)

Abstract

The Enron scandal in 2001 has once again focused attention on the debate of the extent to which auditors are conducting themselves in an independent manner. This study considers the degree to which auditors are acting in the ‘public interest’.

By using interviews and questionnaires societal perceptions of the profession were analysed. Those within the accountancy profession or in accountancy related work were also interviewed, bringing their opinions into the debate.

The concept of the profession as a business, and the extent to which this impacts on public confidence was considered. Two possible methods of improving independence, mandatory auditor rotation and the engagement partner signing the audit report personally were found to meet concerns over the appearance of independence, but not viable in practice.

Declaration of Authorship

I, Colin Millar Dempster, confirm that this work submitted for assessment is my own and is expressed in my own words. Any uses made within it of the works of any other author, in any form (e.g. ideas, equations, figures, text, tables, programs), are properly acknowledged at their point of use. A list of the references used is included.

This dissertation has been completed in accordance with Heriot-Watt University dissertation guidelines – "School of Management and Languages, Undergraduate Dissertation Modules – Dissertation Modules Regulations and Procedures 2002-2003".

Signed: ……………………………………………….

Date: 24th April 2003

Acknowledgements

I wish to acknowledge and express thanks for the advice received from Dr. Katarzyna Kosmala MacLullich, my Dissertation Advisor. I would also like to thank those who kindly agreed to be interviewed as well as those who completed the questionnaire. The advice and information received from everyone was greatly appreciated and of considerable value to this dissertation.

Many thanks.

A copy of this dissertation is available on the Internet:
http://www.imac.fsbusiness.co.uk/dissertation

Contents

Introduction

1.1 Background to the Research

Recent scandals such as the Andersen/Enron fiasco in late 2001 (see Appendix-A) have caused the debate over the independence of auditors to emerge once again. One of the main issues arising is whether Andersen, the auditors, were negligent, or failed in their duty of care to act independently. If auditors are impairing their independence, it could be argued that this is not professional and not in society's interests.

The aim of this research is to attempt to establish the extent to which auditors are acting within the 'public interest', by establishing how society perceives the auditing profession as being independent.

The purpose of an audit is to establish whether the accounts of an enterprise present a "true and fair" view of the state of the affairs of the enterprise at the year-end and are in accordance with relevant legislation (Porter *et al*. (1996)). In order to protect shareholders against management acting in their own interests; it is fundamentally vital that auditors are seen to be acting in good faith and with an independent mind. The audit provides an accountability mechanism, within which faith must be maintained.

In fact if auditors comply with "The Auditors' Code – The Nine Fundamental Principles of Independent Auditing" (APB (1996)) they are deemed to:

> "Express opinions independently of the entity and its directors" (Porter *et al*. (1996)).

There is however a difficulty in defining what being independent actually means; it does not have "a single, unambiguous and fixed meaning" (Gendron *et al*. (2001)). Society should set the boundaries on the level of independence adequate (*ibid*.). Zaid (1997) commented that not only may there be a difference between the profession and society's view of independence but "different groups within the society may have different perceptions of factors affecting auditor's independence … [such that] … independence requirements specifically can not be based on society's values" (p1188). This leaves it for the profession to make judgement, yet there are "some doubts about the seriousness with which the profession views its public obligation to serve the 'public interest'" (Sikka *et al*. (1989: p63)).

Independence "has been a major concern of auditors and users of audit reports since the early days of the profession" (Younkins (1983: p27)). The concept has developed from being "utterly divorced from … participation … that no one could even point an accusing finger" (*ibid*.: p22) in 1928 to "practitioners [being] disturbed to learn that the propriety of offering management services was being challenged" (*ibid*.: p25), during the last quarter of the twentieth century. Auditing is dynamic in nature; it never remains static (Flint (1988); Hatherly (1999)).

1.2 The Purpose of this Study

This study will add to current literature discovering if it is fair to claim that the auditing profession has abandoned professionalism and are instead acting in a self-interested way. On the other hand, perhaps there is simply a lack of communication between the profession and the public. In this case, the profession may be independent 'in fact' but not 'in appearance' (Porter *et al.* (1996)).

1.3 The Strategy Employed

Clough & Nutbrown (2002) see research as a 'moral act', which is in the interests of society. Fundamentally, research adds to the wealth of knowledge, by educating and sparking debates; invoking change if this is necessary.

Using qualitative research techniques, this study will question the perception that society has of the profession and relate this back to the profession's actions and views of the required level of independence that should be in place to serve the 'public interest'. As outlined within the methodology chapter, separate areas of society were identified: the profession, accountants in industry, and the public. Data from the public consisted of responses from among others, family business members, students and members of the teaching profession.

1.4 Structure of the Dissertation

As Ryan *et al* (1992) describe, the word 'dissertation' means a detailed discourse. This makes it essential that information is not presented in a purely descriptive form, but analysed and interpreted.

Firstly, recent literature will be reviewed discovering topics of current interest (e.g. non-audit services and auditor rotation) relating to the independence issue. The literature review will also give insight into the case of Enron and issues arising therein.

Next, the methodology of the study will be explained, showing an epistemological stance of constructionism and the research as being of an interpretative nature.

The final area looked at will include both a demographic analysis of participants and the findings from the empirical study. After this conclusions will be drawn which implicitly will answer the question of how well auditors are fulfilling their role in the eyes of the public.

Chapter Two: The Review of Literature

2.1 The Search for Literature

An initial search for literature was carried out from critical accounting journals, over the past five years as well as from unpublished material available on the Internet. As a result it is hoped that a more relevant piece of work has been produced, reflecting current concerns with the profession.

From this initial search, a network theory was developed, similar to Hesse's (1980) theory (Ryan *et al*. (1992: p153)). Articles considered to be of most importance in the references of initial literature, were selected as additional material. Being selective, this resulted in a backward framework. A network did develop in line with Hesse's (1980) theory with cross-referencing articles.

2.2 The Professionalism of the Profession

Before the 1970s, a perception existed that accountants were not driven by competitive forces to increase their business. It was professionalism that was "assumed to sustain independence in the performance of audits" (Oliverio & Newman (2001: pi)). However, the Accountancy Foundation Review Board (AFRB) (2002) believe "the very nature of the profession means that it is vulnerable to criticism and scepticism … the paradox … a way of making a private living and serving the 'public interest'" (p46). This raises the question of why public confidence has been lost in the profession over the past thirty years.

Macintosh & Shearer (2000) cite Briloff (1990), saying the "profession has violated and desecrated this sacred covenant over the past several decades" (p609).

It is difficult to give a precise definition of 'public interest'; Sikka *et al.* (1989) understand it as the obligation "to embrace the production of impartial accounting and auditing knowledge" (p50). Another definition, provided by the AFRB (2002) is a responsibility "to the community as a whole … [and] … decisions are reached and implemented in an efficient and effective manner" (p7). The problem is that "the consumer has no choice but to trust the professional" (*ibid.*: p35). There must be "general public trust in the independence and integrity of the profession" (Hatherly (1999: p529)) if the profession is to be seen as adding value.

With the recent concerns over Enron it is argued that the public have further lost confidence in the profession. The Co-ordinating Group on Audit and Accounting Issues (CGAAI) (2003) report shows that "Andersen appears to have worked closely with the management … [to keep] … liabilities off the balance sheet, arguably against the interests of shareholders" (p16). "It is inexcusable for auditors to assist clients in deceiving investors to whom they owe a duty of care" (Reeves (2003: p2)). The "collapse of Enron has had a very negative impact on the perception of auditor independence" (Lindberg & Beck (2002: p1)). "It has forever altered the public's view on auditor independence" (*ibid.*: p7).

Dunn & Sikka (1999) take the sceptical view of auditors issuing meaningful audit reports, not warning the public of any disasters. They view auditors as having "a long history of contrived silence" (p55). Audits are not cost effective, contributing "little to the running and improved operation of business, representing low value for money" (AFRB (2002: p36)). Further areas identified by the AFRB (2002) as causing public concern include tick-box auditing, where young graduates are perceived as simply filling out forms and the provision of non-audit services, often with the audit provided at an artificially low cost i.e. 'lowballing'.

Flint (1988) views auditing as the "machinery of social control in securing the accountability of individuals and organisations of every size and type throughout society" (p3). Independent auditing legitimises the information on which financial reporting rests (Gendron *et al*. (2001)). In this respect "auditor independence helps to ensure quality audits and contributes to financial statement users' reliance on the financial reporting process" (Lindberg & Beck (2002: p2)). "If auditing is to continue to enjoy the respect of those who rely on its services it must be and appear to be quite independent. If auditing is to take its place as part of the mechanism of social control it must be accepted as thoroughly independent" (Mautz & Sharaf (1961: p224)).

Unfortunately, Lee (2002) sees commercialism becoming more dominant against the background of professionalism. The value of audit is "violated by the presence of commercial concerns … [which] … denies the reality of auditing as a professional service" (p318). Hatherly (1999) identifies that "the *auditor* cannot be independent because *'auditing'* is no longer independent" (p517; *original emphasis*). The conflict of the need for independence and the provision of a commercial service have caused the profession to continue to demonstrate independence "so that its reputation can provide a springboard into more competitive markets" (Citron (2001: p13)). There is a requirement for the profession not simply to reassert independence but redefine it to meet a new reality (*ibid.*). The profession endeavours to redefine independence because "any weakening of the *aura of independence* renders professionals (more) vulnerable to the claims of predatory groups, that may seek to occupy their jurisdiction" (Sikka & Willmott (1995: p554; *original emphasis*)). In so doing the profession is effectively moving the goal post.

Commercial pressures intensify the reduction in audit work (Lee (2002)). "Arthur Andersen & Co, long since one of the most business minded of the professional service firms" (Hatherly (1999: p520)) may have met its downfall simply by lacking professionalism. Nevertheless, "looking to the future … the very size of the big firms gives them considerable protection from competition" (Sikka & Willmott (1995: p575)).

In 1996, the accountancy profession published a statement moving towards "an adequate degree of independence from being, and being seen to be independent" (Citron (2001: p42)). Questions arise as to whether this is merely "to carve out a monopoly position for the accounting firms" (*ibid.*: p43) in the supply of non-audit work. It appears that the profession has not subordinated their interests to those of the public, as it would need to do in order to legitimise monopoly powers (Sikka *et al*. (1989)). The profession's ethical guidelines are structured to promote its own best interests (Citron (2001)). The power to control and define independence is of "crucial interest to the audit industry" (Hatherly (1999: p527)).

The self-interest of accountancy bodies should be closely correlated with those of the public (AFRB (2002)). According to the Big Six in 1991, "'independence' should be considered from the perspective of a *reasonable and prudent person* who possesses both *knowledge and experience*" (Zeff (1998: p537; *original emphasis*)). In this case it appears that the views of the public no longer are of concern. Sikka & Willmott (1995) put forth a claim that it was believed "that only individuals trained and regulated by their own associations were fit to act as 'independent' auditors" (p554). This shows that since independence is only a claim, it can be contested. Auditors "are obliged to articulate and defend … regulatory practices that reassures the public that they (can be trusted to) act independently" (*ibid.*: p554).

Without independent and effective legislation, auditors remain "'economical' with information and keep the public in the dark" (Dunn & Sikka (1999: p23)). The regulation of auditing "is for the benefit of the public, but there are no directly elected public representatives on the councils of the accountancy bodies" (Sikka (2001: p752)). Regulations are present to "propagate the belief that the profession is the guardian of ethics, competence, independent and accountability … it is as though the symbolism … [of regulation] … is considered to be sufficient to secure public confidence" (*ibid.*: p755/756).

Claims of professional independence are "routinely appeased by introducing some reforms and refinements "into the self-regulatory system" (Sikka & Willmott (1995: p550)). However when standard setting "is dominated by the major accounting firms … like other self-regulatory structures, it functions more as an agency of self-protection than of effective regulation" (*ibid.*: p567).

2.3 The Appearance of Independence

Flint (1988) states "auditors who were not independent of the audited would be of little value to the individuals to whom the accountability was due" (p57). Mautz & Sharaf (1961) take this one step further saying "real independence is of little value if those who read auditor's reports refuse to acknowledge that independence does exist" (p204). This draws out the realisation that there is more than just the 'true' independence of the profession to consider; independence must be communicated to the public at large.

It is crucial that there is public belief in the independent profession. However, Flint (1988) questions why users should believe that auditors have not been under pressure to improper influences, improving their own position. John Wosner, chairman of PKF stated:

> "the whole profession needs to improve the perception. It is the worst in my whole career" (Parker (2002: p2))

"Perception is critical" (Parker (2003b: p2)) to the profession. Mautz & Sharaf (1961) identify two areas of independence these being: practitioner-independence and professional-independence. Ansong *et al.* (2000) specify "an auditor's independence can be impaired by any real or perceived condition which prevents him or her from rendering an impartial, objective opinion of client's statements" (p2). In analysis, it can be considered that practitioner-independence is the 'real' element of independence, while professional-independence is the appearance given to society.

Ansong *et al.* (2000) provide a definition from Bartlet (1991) of independence 'in fact' or alternatively practitioner-independence:

> "the absence of positive or negative bias or predisposition towards a client" – "the auditor's ability in specific situations to make unbiased decisions regarding the various aspects of the audit process" (p3);

and by Parkash & Venable (1993), of apparent independence:

> "independence 'in appearance' relates to the perception of users that auditors are able to render unbiased audit decisions, perceptions which can arise ex ante or ex poste the audit" (p3).

Independence 'in fact' cannot be observed, this means that the appearance of the profession acts as a signalling device to the underlying factual independence (Ansong *et al.* (2000)). Independence 'in fact' is a 'state of mind' a 'mental attitude' (Ansong *et al.* (2000); Lindberg & Beck (2002); Mautz & Sharaf (1961)). Sherer & Kent (1983) describe the auditor as being "independent, both mentally and physically" (p24). The "essence … [is] … embodied in individual auditor's mind" (Lindberg & Beck (2002: p3)). If users do not believe, via the appearance communicated, of auditors as being independent then "investor confidence is eroded" (*ibid.*: p3). Society determines the factors that affect the view of independence, these factors "may not coincide with those perceived by the auditors themselves" (Zaid (1997:

p1188)). To trust the numbers, the public must have confidence in the auditor’s objectivity and fairness (Jenkins & Krawczyk (2000)). The public must have “trust in the independence and integrity of the audit profession” (Jeppesen (1998: p529)).

Ansong *et al*. (2000) refer to Bazerman *et al*. (1997) where it is said that it is psychologically impossible to maintain full independence. Even the most moral auditor could not achieve total independence because of unintentional bias. Minor infringements of independence are to be expected, but these may be totally irrelevant in considering the quality of the audit statement (Mautz & Sharaf (1961)). However, “the greatest threat to his independence is a slow gradual almost casual erosion of his ‘honest disinterestedness’” (*ibid*.: p208).

Mautz & Sharaf (1961) identified three dimensions of practitioner-independence: programming, investigative and reporting independence (see Appendix-B). Flint (1988: pp 63-84) also gives factors that must be satisfied if ‘real’ independence is to be maintained. Of foremost importance is the personal quality of the auditor, who must have strength of character and high moral and ethical standards. An auditor should not have any non-professional relationship with the client; Flint (1988) notes that this extends beyond immediate relatives:

> “the bond of loyalty or emotion with a personal friend can be strong … it is the principal which is important” (p65).

Benefits provided might have no “sinister purpose”, but have the ability to impair the appearance of independence (*ibid*.: p65).

An auditor must judge the level of their independence as to how "a reasonable observer would view [the] situation as impairing the [auditor's] independence" (Ansong *et al*. (2000: p10)). The maintenance of an image is vital:

> "to many people who have never had direct acquaintance with independent auditors, the term still has a meaning, a meaning which they have gained from what they have read from the mass communication media" (Mautz & Sharaf (1961: p205)).

According to Flint (1988) the reality of an auditor's independence must be made apparent to the reported, "all persons who hold themselves out to be auditors have therefore a common interest in protecting institutional reputation" (p62).

When writing about the Enron case, Lindberg & Beck (2002), give notice to the fact that many writers have identified that "perception becomes reality where auditor independence is concerned" (p8). Therefore, as Neidermeyer *et al*. (2002) make clear, "the mere interpretation by a third party of an auditor's lack of independence is enough to suggest … [that such practices] … are unacceptable" (p8). It is no surprise then that after Enron, "several of the Big 5 CPA [now Big 4] professional firms have sold their consultancy practices" (Lindberg & Beck (2002: p7)). However, as Parker (2003b) identifies, the consultancy practices are being rebuilt, called advisory services.

Increasingly the auditing profession has become business orientated; auditing is one of many products on offer (Jeppesen (1998)). Jenkins & Krawczyk (2000) found a similar pattern in their results; there is a fundamental shift of focus towards business rather than professionalism. This move towards business and lack of independence 'in appearance' has caused users of financial statements to question the value of an audit (Jeppesen (1998)). The investing public, and financial community are sceptical of auditors (Ansong *et al*. (2000)).

User scepticism, Flint (1988) argues can be overcome through the regulatory bodies that monitor the profession and set sanctions on those who depart from established norms. In agreement with Flint (1988), Ansong *et al.* (2000) note that users have to rely on "auditors integrity, self-interest, and fear of sanctions such as litigation, professional disciplinary action or loss of reputation to ascertain that the auditor is independent 'in fact'" (p4). "Adherence to the rules creates an appearance of independence" (*ibid*.: p3).

Despite this, scepticism remains with the profession. Elliot & Jacobson (1998) as cited by Jeppesen (1998) believe that independence in appearance has already been abandoned. They continue with the view that "independence (in fact) is not really important as long as the auditor is objective" (p533) and maintains integrity. Regardless of this extreme viewpoint, Ansong *et al.* (2000) would argue that the most "critical concern is to maintain independence in appearance" (p4) – it is the only way for the public to be able to believe in the profession.

2.4 Improving Independence

One of the methods of strengthening the independence of auditors is believed to be the engagement of a practice of mandatory auditor rotation. In a study by Accountancy Age (2002), a majority of Finance Directors believed that auditors should be forced to change every four to seven years. To an extent it does not matter if rotation improves independence 'in fact', as it does improve "the perception of independence and thus confidence in the audit" (CGAAI (2003: p25)).

Contradictory to the presumption that rotation is ideal, Walker *et al*. (1998) found that rates of audit failures were considerably lower when an audit firm had a longer-term relationship with a client. This would indicate that the enforced rotation of auditors was not a valid policy. Bruce (2002) views the idea of mandatory auditor rotation as "deeply flawed" (p20). Broom (2002), on the other hand, considers that mandatory auditor rotation, along with similar measures, would allow Finance Directors to see the wide range of audit firms that were able to offer their services, rather than the restricted view of the Big Four.

Despite this, Teoh & Lim (1996), reporting on Malaysian auditing activities, discovered that non-rotation of auditors, although significant, was not dominant within the factors that impaired the perception of the profession as being independent. However, within Malaysia it was considered that the custom of many of the larger firms already practicing rotation of audit partners mitigated the improvements that total rotation would have on perceptions of independence.

In the United Kingdom, the government has “fallen in line with the industry’s pre-emptive move merely to change the lead audit partner every five years” (Dickson (2003: p22)). This indicates similar conclusions as Teoh & Lim (1996), that mandatory auditor rotation should not be implemented. No mention however, has been made of the rotation of audit personnel, it has simply been a discussion about the audit partner. Holding a strong opinion against this limited measure Parker (2003b) argues that “rotation of partners does not solve the issue of audit firm culture … changing the figurehead will not ensure independence and objectivity” (p2).

The opposing views of mandatory auditor rotation support improvements in independence in differing ways. Firstly if auditors have a long-term relationship they are likely to get too close to their clients, become stale in audit approaches losing professional scepticism and objectivity (Walker *et al.* (1998)). Porter *et al.* (1996) consider that auditors may “make assumptions about such things as the effectiveness of internal controls … based on the findings of previous audits, instead of objectively evaluating current evidence” (p73) in a long-term relationship. Bruce (2002) notes that even with mandatory auditor rotation “there is a perception on both sides of a reduction in quality … they see it as a trade off” (p20).

Lack of auditor rotation can also be argued to maintain independence. Valuable knowledge is gained over a period. If a policy of mandatory auditor rotation was introduced "new auditors need to go up the learning curve" (CGAAI (2003: p26)). By forcing a change of auditors this would lead to poorer quality audits: "a company might have to appoint new auditors just as the quality of audit work was improving" (Porter *et al.* (1996: p74)). Parker (2003a) claims that the Big Four are concerned about mandatory auditor rotation because "a lot of people with good knowledge of a company would have to stop their audit work after five years" (p3). Mandatory auditor rotation could reduce incentives for auditors to improve their efficiency or quality, and "auditors near the end of their term might have diminished performance incentives" (CGAAI (2003: p75)). Porter *et al.* (1996) identified that "the initial years of any audit are very costly … [and] … benefits to be gained from subsequent, lower cost years, would not be fully realised" (p74).

In summary to their paper, Walker *et al.* (1998) point out that although there is not a strong case for mandatory auditor rotation, since long-term auditor-client relationships are less likely to fail, care must be taken in considering political factors. Thinking of scandals such as Enron, "there is intense public scrutiny and criticism following such failures … [so] … legislative institutions will feel pressured" (*ibid.*: p10)) to put in place policies like mandatory rotation. Although mandatory auditor rotation has once again been discussed in the United Kingdom after Enron, it has not found support as an adequate policy. The CGAAI (2003) "considered the arguments and conclude[d] that the balance of advantage is against requiring mandatory auditor rotation" (p25).

Another suggestion put forward has been increasing auditor's responsibility for their actions. An audit is a judgement, "an expert view with personal accountability" (Jeppesen (1998: p52)). Zeff refers to the suggestion made by the ICAS Research Committee (1993), that the engagement partner should "sign the audit report jointly with the firm … [reminding them] … of their responsibility to the public" (p540). Currently the partners are shielded from the public light.

2.5 Is Independence Necessary?

Although it is claimed and universally supported that independence is the most important of the audit postulates (Flint (1988)). Grout *et al*. (1994) argue that:

> "some policies which have been designed and enacted to increase the independence of auditors from their clients may have the opposite effect to that intended" (p311).

It is viewed that professional judgement should be exercised and that does not mean that auditors could not provide other services (*ibid.*).

Grout *et al*. (1994) consider that if auditors based all decisions on quantifiable material, then there would be no need for professional judgement, however, non-quantifiable material does exist. "This subjective and non-quantifiable information … [is not recorded] … directly within the accounts … [but that] … does not mean that auditors do not base decisions on it" (p310). The auditor's job of assessing the quality of accounts is "more subjective that totting up the numbers for the last twelve months" (Economist (17/10/92: p26)).

A degree of dependence on clients may in fact improve the quality of financial reports (Grout *et al*. (1995)). Further, auditors are liable to be sued and so will be "cautious in exercising their flexibility" (*ibid*.: p75). In this way professional judgement can flourish, bringing higher value to the public than the traditional audit, even though they may appear less independent (Jeppesen (1998)).

2.6 Non-Audit Services

Non-audit services have increased substantially over the last few years, leading to a greater prominence of suspected independence issues (Canning & Gwilliam (1999); Jenkins & Krawczyk (2000); Oliverio & Newman (2001)). The concept arose when client's found it convenient to use auditors for all their needs (Pawlyna (2002)). Regardless the profession must manage "the fundamental incompatibility of providing auditing and consulting services" (Hatherly (1999: p529)). Oliverio & Newman (2001) cannot see "how non-audit services enhance the … audit … accounting firms for several decades claimed that firewalls separated their auditing function from their consulting" (p19/20).

"Auditing is distinguished from consulting by the independence requirement in auditing being defined as the absence of economic interest in the auditee" (Jeppesen (1998: p525)). The 'reinvention' of auditing has caused auditing to "consequently become consulting and it makes little sense distinguishing between the two as the boundary between them is eroded" (*ibid*.: p526).

Gendron *et al*. (2001) view independence "as a commodity, people can make choices about how much independence they wish to supply or purchase" (p285). The Institute of Chartered Accountants of Alberta (ICAA) "recognise that it may be in the public interest that auditors compromise their independence, in order to provide 'useful' services" (*ibid.*: p286). Gilchrist (2002) discusses the situation where entrepreneurs "attach little value to the audit and are more interested in the advisory role … a benefit driven service where the client will pay handsomely" (p69).

In *Accountancy's* report on proportions of non-audit to audit services, they see "non-audit fees at an all time high. The gap between audit and non-audit is the widest ever" (Sept 2002: p13). Still no research can prove that non-audit services are damaging to independence, "but the subject is difficult to research because the audit process is unobservable" (Reeves (2003: p2)). Jeppesen (1998) holds that "apparently auditing in itself is not considered to be of value to the auditee. Something extra has to be delivered" (p521).

Lennox (1999) draws from the work of DeAngelo (1981) saying, "audit quality depends on both discovery and disclosure of problems" (p239). The probability of an auditor disclosing any problems identified depends on the level of independence (*ibid.*). Arthur Andersen, have been criticised for impairing their independence, since they earned more from non-audit work than the audit itself (Lindberg & Beck (2002)). As DeAngelo (1981) indicates this may be one of the reasons why the Enron problems were not discovered sooner.

Considering the two possible arguments, Lennox (1999) gives reasons why the provision of non-audit services may be beneficial or detrimental to the quality of the work undertaken. Non-audit services may increase the knowledge that an auditor has of a client's business and management, therefore the probability of discovering problems (CGAAI (2003)). Thus, given a set rate of independence the quality expected from an audit would increase (Lennox (1999)). A reduction in non-audit services would not be beneficial because 'soft' information is vital in assessing business condition (Grout *et al*. (1995)). The profession may defend their actions with a view that "new audits provide a much better platform for the detection of going-concern problems and substantial frauds, thereby serving the interests of the public" (Jeppesen (1998: p531)). Canning & Gwilliam (1999) identified users as "willing to accept a degree of reduction in independence if non-audit services … [were provided giving] … more cost-effective advice or a higher standard of audit" (p401).

Alternatively, non-audit services may reduce independence affecting quality (Lennox (1999)). If non-audit services are perceived as escalating an economic bond within the auditor-client relationship, auditor independence may be adversely affected (Jenkins & Krawczyk (2000)). The study by Lindberg & Beck (2002) supports this view:

> "Non-audit services affect the public's *perception* of independence to a greater extent than they adversely influence *actual* independence" (p4; *original emphasis*)

Nevertheless, it is the appearance of independence that is of most importance to the public, since it is the signalling device.

It is important that an appearance is given, showing that auditors are not dependent on their clients for fee income. There is an argument that non-audit services may increase an auditor's dependence on a client causing the auditor to bow to management pressure to retain the audit (Lennox (1999)). Grout *et al*. (1994) consider that diversification of interests may occur if auditors are allowed to provide non-audit services therefore decreasing reliance on a single client. However, management often is dependent on the auditors and so the credibility of the 'switch of auditors' theory is diminished (Lennox (1999)), as a result, the auditor can still provide an objective view. When carrying out non-audit services an auditor is providing distinctive work increasing their "ability to resist management pressure and thus maintain their independence" (Jenkins & Krawczyk (2000: p4)).

The provision of non-audit services is still questioned by the public since "an audit firm may be unwilling to criticize the work carried out by its consultancy division, and it may not wish to lose lucrative consultancy services" (Lennox (1999: p240)). Yet, Jenkins & Krawczyk (2000) refer to Kinney (1999) who showed that no substantial evidence existed of investor concerns with non-audit services. The results of Lennox's (1999) survey suggested "separation of services provided the majority of interviewees with confidence that independence was not reduced from the provision of non-audit services" (p409). But "the fortunes of the two fields will always be interlinked … only formal legislation will keep the two wings apart in the long run" (McKenna (2002: p72)).

Grout *et al*. (1994) accept "since consultancy is generally regarded as more profitable than auditing, the value to a firm of retaining an audit is far more than the marginal return from auditing" (p326). It is not surprising to see this view, as *Accountancy* show, "audit fees are stagnant" (Sept 2002: p13). The profitable service is the non-audit work, with "audit the strategic necessary which … can be a loss leader" (Jeppesen (1998: p58)). Parker (2003b), however, claims that "only a fool would be unable to make money in this environment" (p2) and so to claim provision of non-audit services on this basis is unfounded.

Several steps have been suggested to improve confidence. Four main alternatives exist: non-audit work could be prevented through regulation (a total ban); there could be a restriction on services available for provision to audit clients (e.g. new SEC regulation, see Appendix-C); disclosure could be enforced (as in the UK); or, audit and non-audit work could be separated into different segments, either departmentally or externally (Canning & Gwilliam (1999)).

UK legislation requires that annual reports and accounts show the amount, which has been paid to auditors for both audit and non-audit work, this does not mean however, that the information is easy to locate (Accountancy (Sept 2002)). Investors, in the study by Jenkins & Krawczyk (2000), favoured full disclosure of non-audit services, whereas CPA firm professionals believed that disclosure of the amount only would be sufficient if services exceeded a specified threshold. This suggests a level of secrecy within larger firms, possibly aware of perceived public feeling towards the provision of non-audit services.

The study by Canning & Gwilliam (1999) found that "perceptions of auditor independence were significantly diminished when non-audit services were provided to clients by personal involvement in the audit rather than by whether a separate department within the audit firm or to non-audit clients only" (p401). Parker (2003b) believes that the industry "requires clear demarcation to remove the faintest suspicion" (p2). Contrastingly, Jenkins & Krawczyk (2000) concluded that participants were more willing to rely on the auditor's opinion when non-audit services had been provided. Another outcome was identified by Lennox (1999) where a significant proportion of respondents were undecided as to whether non-audit services provided an impairment of an auditor's independence.

In the case of a smaller firm, it is clearly not practical to separate audit and non-audit work (Pawlyna (2002)). A small firm does not have the resources to perform an audit of a large company, as "a single major client might compose such a significant proportion of its practice and contribute so substantially to its revenues as to raise embarrassing questions" (Mautz & Sharaf (1961: p213)). Mautz & Sharaf (1961) considered how to overcome this problem and suggested three alternatives: prohibiting such services; allowing a choice as to which variety the smaller firm made; or, leave things as they stand. The most appropriate was considered to allow small firms to provide both since "smaller firms carry out audits of limited usefulness" (*ibid.*: p277). This is in addition to the conclusion reached by Pawlyna (2002) that to have such a requirement would be onerous on the smaller firm and have "little advantage to be gained from a regulatory viewpoint" (p32). Even so according to Shockley's (1981) study, Jenkins & Krawczyk (2000), along with their own evidence found that large "CPA firm professionals may have a fundamentally different perception of 'auditor independence' [versus other parties]" (p16). Local partners weighed non-audit services as more likely to impair independence than the large CPA firms.

The SEC considers nine non-audit services to be a conflict of interests to independence. These are outlined in Appendix-C. The "Big 5 [now Big 4] CPA firms oppose the SEC's efforts to some degree, while many [smaller] firms support [the SEC]" (Jenkins & Krawczyk (2000: p1)). This is further evidence of the difference in perception between the larger professional firm and the smaller practice.

Lowballing is another contentious issue relating to non-audit services, it has been outlawed in Texas since 1991 (Grout *et al.* (1994)). Neidermeyer *et al.* (2002) cite the Cohen Commission (1978) who suggested that lowballing impairs independence by creating the effect of an account receivable. Canning & Gwilliam (1999) state that audits by major UK auditing firms have been allegedly used as loss leaders to get 'a foot in the door' before securing profitable non-audit work. They cite Mitchell *et al.* (1993) who say, "it is an abuse of the statutory monopoly of the external audit function" (p403). DeAngelo (1981), as referred to by Grout *et al.* (1994), views "lowballing as competition today for quasi-rents in the future" (p325). Grout *et al.* (1994) disagree with DeAngelo's (1981) statement believing the banning of lowballing would have the effect of further increasing quasi-rents rather than decreasing them.

"It appears that the debate over the issue will apparently not end soon" (Pawlyna (2002: p34)). Oliverio & Newman (2001) accept that "good judgement by both parties is the key to avoiding problems" (p15). There is scope for a degree of mutual dependence and negotiation between the auditor and client in order to represent a 'true and fair' view (Grout *et al.* (1995)). Non-audit services are not necessarily the evil of audit.

Chapter Three: Methodological Stance

3.1 Value of the Research

There is true value-added to this research as it interacts with the climate of suspicion that currently surrounds the profession (O'Neill (2002)). I am sincerely interested in this topic, as a member of society myself. The researcher is one of many parts of the social world that is being studied (Alvesson (2003)). 'I am an actor' (Dey (2002); Morgan & Smircich (1980)) within my surroundings. This makes me, as a person, prone to the influences of society, looking for understanding of world situations.

Initially it would have to be admitted that had the Andersen/Enron scandal not occurred in 2001, this issue might not have emerged as a predominant research topic. It is crucial, however, that research keeps pace with time and external events. Research interacts with the world and must be of contemporary nature to meet societal needs (Clough & Nutbrown (2002)). There is a political requirement for understanding and action after large corporate failures. Research is required to provide direction, to evaluate the situation and any proposals for reform.

3.2 Implications for Policy Makers

Should this study have the effect of discovering that auditors are not independent, therefore not acting in society's interests, it can only be hoped, along with other supporting evidence, that changes will be made within the profession. Nevertheless, should it be discovered that the suspicion from the public is without grounding, the work will find support for maintaining the status quo.

3.3 Informing the Research Perspective

According to Crotty (1998) both ontology and epistemology may be grouped together "as each theoretical perspective embodies a certain way of understanding *what is* (ontology) as well as a certain way of understanding *what it means to know* (epistemology)" (p10; *original emphasis*). Therefore, ontology is viewed as how one sees the construction of the world whereas epistemology is philosophically based (Hatch (1997)). This relates to the research with the comparison of what exists in terms of independence of the profession to the communication given to society. Society does not necessarily see the whole picture, they see only an 'appearance', not full reality.

Burrell & Morgan (1979) cited by Morgan & Smircich (1980) view that a researcher's approach is based on the individual's own assumptions of ontology and epistemology. Clough & Nutbrown (2002) state that through examination of empirical research:

> "it is clear that there are a great many assumptions about what the world is, how it works and how we can claim to know these things" (p30).

This is important in understanding conclusions drawn from this study. In the view of Alvesson and Sköldberg (2000) "it is not methods but ontology and epistemology which are the determinants of good social science" (p4).

Hatch (1997) discusses taking an "objective position [to epistemology] mean[ing] believing that the world exists independently of our knowledge of it" (p47). The fact that the objective view is structured accordingly shows "a pressure to get it right: to display a unified, consensual culture in the way it 'actually' exists" (Alvesson & Deetz (2000: p34)). Although seeking concrete answers to the research questions, which an objective viewpoint would provide, the epistemological stance taken is not one of 'true' objectivity.

According to explanations by Crotty (1998) of different epistemologies, this research has a stance of constructionism, where the viewpoint cannot "be described simply as 'objective' … [nor] … simply as 'subjective'" (*ibid.*: p43). Constructionism is somewhere in between the objective and subjective. It is obvious "that different people may construct meanings in different ways even in relation to the same phenomena" (*ibid.*: p9). This corresponds to different individual's perceptions of auditors; auditors as a whole can be considered a phenomenon. Although, I do believe that an objective truth does exist, hidden by language. "Language is by nature metaphorical, figurative and context-dependent, and not very successful at mirroring complex circumstances" (Alvesson & Sköldberg (2000: p202)).

From the subjective viewpoint on the continuum of ontology and human nature the whole concept of reality is questioned (Morgan & Smircich (1980)). Does society fall under the spell of impression management or do they work together to create a shared reality? Understanding the perceptions of auditors from society's seat in the stadium of life is extremely thought provoking.

Nevertheless, in answering the research questions it is a requirement that society's opinions be brought to the surface and in so doing so bring forth the language barrier. Yet, language is how one expresses oneself to another, "we cannot escape these effects of language" (Burr (1998: p19)). Every communication made is a form of language, subject to possible incorrect interpretation. The medium of language is one "in which we conduct our social lives and create our symbolic existence" (Alvesson & Sköldberg (2000: p200)). To fully investigate the topic, society has been divided into three distinct areas.

Reasons for doing so are to firstly attempt to prevent bias in the work and secondly "the study of *subgroups* within broader social formations" (Alvesson & Sköldberg (2000: p200)) has been a main area of discourse analysis – understanding the different perceptions that exist of a phenomenon. Accountants, although part of society themselves, have been segregated in order to provide a balanced view.

The areas identified were: the profession of accountancy; those working in industry (accounting related); and finally the 'true' public to whom auditors should have some responsibility; or at least to the shareholders as required in the Companies Act 1985. This is the fundamental point to the research. What is perhaps true or obvious in a regulatory sense does not necessarily translate into what 'society' actually wants (Zaid (1997)). The only way to answer this is to investigate society's perceptions of auditors. This requirement will be translated into the research by questioning the public's views and comparing them with those with an accountancy background or themselves in the profession.

3.4 The Research Perspective

In terms of Cohen *et al.*'s (2000) explanation of the different approaches to research (reproduced in Clough & Nutbrown (2002: p16)), this research falls into the area of an interpretative study. It is a small-scale investigation focusing on the perceptions of individuals, understanding their beliefs, rather than necessarily why they believe. Crotty (1998) makes reference to Blakie (1993) who considers interpretivism as "entail[ing] an ontology in which social reality is regarded as the product of processes by which social actors together negotiate the meanings for actions and situations" (p11). As discussed earlier, this gives direction to the study, with an understanding of the impact of the current professional 'crisis'.

Overall, the study will show operations of power and how this has an impact on societal beliefs. Rather than an analysis of the technical, or for practical purposes, I intend to emancipate interest and encourage change if deemed necessary by giving clear conclusions. As Laughlin (1987) states:

> "Interpretation is never for its own sake but forms part of the important understanding which can allow some desired 'transformation' of societies and their institutions so that a 'true, free and just life' can be assured" (p482).

With precise conclusions, society is given further verified knowledge, with which decisions can be based on. In this way change will be prompted if necessary, improving the quality of life, with credible information.

3.5 The Research Perspective in Relation to Data Collection

In order to carry out qualitative research an element of faith has to be placed within the knowledge gained. Alvesson (2003) is concerned that all too often much faith is present in what is effectively subjective information. Identified later are the research methods of interviewing and questionnaires, which subject themselves to this faith element.

Alvesson (2003) raises issues of truth and trust; he sees that in order to gain any truthful responses to research questions, it is a prerequisite that understanding is present between researcher and participant. In terms of the interview, it is impossible, without understanding for the interviewee to reveal their inner feelings and experiences without responding in a conservative manner. There is a "field of tensions between different logics (e.g. communication of facts and experiences, political action, script following, and impression management)" (*ibid.*: p14). If a manager is being asked about the levels of communication from top to bottom of an organisation, as expressed by Alvesson (2003), they are liable to answer in a form of praise. This will be "in the most effusive terms, probably reflecting an interest in using the research to promote themselves" (p22) or face comeback if views of a controversial nature are disclosed. This may be a morally adequate account rather than the truth that is presented (*ibid.*).

For the purposes of this research, these criticisms will not damage the research conclusions. As an external body gathering information for a purpose not connected with the practical accounting world, there is no reason for subjects to exaggerate the truth. Riessman (1993) cites The Personal Narratives Group (1989) saying that "people lie sometimes, forget a lot, exaggerate … they *are* revealing truths … truths of our experiences" (p22; *original emphasis*). It is the 'truth of experience' that equates to perception and understanding.

Looking at the perceptions of the profession conveyed to the public, it is the disclosure that is important. Moreover, whether this is the 'truth' is not important. It is the fact that such a response has been communicated. Alvesson & Deetz (2000) consider people not as "objects like other objects, but as active sense makers like the researcher" in interpretative studies (p33).

An interview can only communicate the interviewee's thoughts or values about their beliefs of reality; it is not possible from this to work out what is real (Maxwell (1996) referred to by Wengraf (2001)). However, by taking a relativism stance there is a vision of "a reasoned and enlightened quest for the real" (Brown *et al.* (1998: p79)). The research process will constitute "a (re)construction of social reality … creating images" (Alvesson & Sköldberg (2000: p6)). These images will be interpreted as the relativism of the world.

Qualitative methods, such as interviewing can be viewed as 'soft' since they are often descriptive. Yet, "reality (and the truth) is not tidy" (Gillham (2000b:

p10)). Interviews can be seen as seeking only the subject's perceptions. This research will seek to discover the perceptions that members of the different sub-sections of society have, seeing if there is any relationship between them, perhaps only by way of disagreement.

3.6 The Methodology Behind the Methods

As outlined, I have detailed the requirements needed for data that will enable conclusions to be drawn. Clough & Nutbrown (2002) state that:

> "Methods should be seen as being *constructed* (for particular purposes) rather than *selected* (for any general usefulness)" (p17; *original emphasis*).

Strong agreement can be held with this view as various methods may be employed. Yet, it depends on the researcher's objective as to which will achieve the research aim. Clough & Nutbrown (2002) say that methodology should show not how one method appeared to be the most effective:

> "but how and why *this way of doing it was unavoidable – was required by – the context and purpose of this particular enquiry*" (p17; *original emphasis*).

Nevertheless, "methodology influences how one sees methods and does not influence the choice of methods" (Haslam (2001)). Crotty (1998) views that "justification of our choices and particular use of methodology and methods is something that reaches into the assumptions about reality that we bring to our work" (p2).

In relation to this study the belief of requiring active communication with participants requires that qualitative methods are best suited. In this way, the deepest insight into the world as others see it will be gained. Alvesson & Deetz (2000) view theory as a way of seeing and thinking about the world, rather than a set representation of it. It is discussed that theory can be described as a lens – of which there are various types e.g. the microscope or telescope – each gives a different view.

Morgan & Smircich (1980) describe the dichotomy between qualitative and quantitative as being oversimplified. A discussion is made regarding the swing from empiricism of the 1960s and 1970s to the 1980s and beyond. They state that:

> "There is a danger that one kind of abstracted empiricism will be replaced by another" (p491).

Nevertheless a detailed analysis is necessary and a tick-box approach would not suit the depth required. However, one area that could be considered of concern is triangulation where different research strategies may be used with no methodological foundation. Although a questionnaire was a method employed in addition to the interviews, it was constructed in such a way that it guided responses of qualitative nature rather than quantitative 'yes' or 'no' answers. In this way it will be possible to use discourse analysis as the methodology behind both methods utilised.

3.7 Research Questions

In order to carry out a piece of research successfully it is necessary to quantify questions, related to the aims and objectives of the investigation. These are detailed below:

- *What perception does society have of auditors?*

- *Are auditors acting with an independent mind?*
- *Is the profession acting in a self-interested way, abandoning a duty of professionalism?*
- *What effect has Enron had on society's perception of auditor independence?*

3.8 Data Collection

"Research is about creating new knowledge" (Gillham (2000a)), a researcher who is open-minded about knowledge creation will not know in which direction the responses from questioning will take. Gillham (2000a)) also indicates that it is "impressive how people will respond to an interview, [treating it] as a special occasion" (p7). "The willingness of people to work at an interview when it is of no *direct* significance to them reflects the fact that people are often not listened to; that their views and experiences are not treated as being of any account. If you are interested and you *listen* you may be surprised at the richness of what emerges, expressed in a way that commands attention" (*ibid.*: p7/8; *original emphasis*). An example of an interviewee 'working at an interview' was with one of the CAs interviewed thoughtfully providing additional material to aid research. This view is also of relevance to the questionnaire responses. In analysis of both the interviews and questionnaires, richness emerges with contrasting opinions.

Interviewees were seen as 'participants' as opposed to subjects of research. Following on from this I have, as Holstein & Gubrium (1997) cited by Alvesson (2003), taken the opinion expressed and emotions conveyed into a source of knowledge, which will stimulate consideration of the here-and-now of the profession.

Gillham (2000b: p60) identified a continuum of interviews; from the listening and verbal observations to the extreme of simple, specific closed questions. Placing the interviews for this dissertation along the continuum, a form of natural conversation was used, "establishing rapport, trust and commitment" (Alvesson (2003: p16)). The interviewees were not restricted on the topics that they could discuss. Although a guide of interview questions was in place, this was not adhered to on a strictly numerical order basis. As issues arose in the interview, they were discussed.

The interviews were loosely structured, as qualitative interviewing is (Alvesson (2003)). In the semi-standardised interview, Flick (1998) notes, "the interviewee has a complex stock of knowledge about the topic under study … [expressing answers] … spontaneously in answering an open question" (p82). Using closed questions, would not have satisfied the requirements of this investigation.

Interviewees were allowed to speak for themselves (Gillham (2000a)), with the occasional clarifying question. In this way, the interview was more relaxed, making the interviewee feel more comfortable about expressing their opinions. Listening, with clarifying questions occasionally, is part of observation and understanding of one's perceptions (Gillham (2000b)). Notwithstanding this, Gilchrist (1992) realised:

> "the informant, however, needs to be thoroughly encultured and currently active within his or her own culture in order to represent accurately that culture to the researcher" (p 75).

This is an area, which relates back to ontological principles present. Informants had to be placed into their culture: practice, related or public. It was essential to collect knowledge from key people, with open questions needing an extended response.

3.9 The Interviews and Questionnaires

In the tables (*Table 4.1.a and Table 4.1.b*) it is possible to see a breakdown of the participants used for this study. It was believed necessary that anonymity be provided to protect against any personal opinions, not welcome if expressed explicitly.

Apart from the Director of Accounting and the Internal Auditor, the interviews were held face-to-face, at a suitable convenient location. For the Audit Partners this was at their respective offices, in order for them to feel comfortable in their own surroundings. Due to location constraints both the "industry" participants were interviewed over the telephone. All interviews were recorded and transcribed to aid analysis.

Various participants completed the research questionnaires. The participants had no prior direct experience of accounting/auditing. This forms along with the interviewed public the basis for considering the public's perception of the auditing profession.

3.10 The Analysis and Categorisation of Data

It is important in the analysis that a prejudice is not given to either side of the argument; Gillham (2000a) identifies:

> "the best lies are half-truths and carefully selected quotations can totally distort the picture. An honest balance has to be struck" (p76).

Each transcript was analysed for: "*substantive* statements – statements that really say something" (Gillham (2000b: p71; *original emphasis)).* One problem with transcribing is that inevitably self-representation is brought forth (Goffman (1959) referred to by Riessman (1993)). "Transcribing … is … incomplete, partial, and selective" (*ibid.*: p11). It is impossible simply through an interview to enter the mind of the subject.

Mishler (1991) cited by Riessman (1993) considers that the various transcription practices available can have remarkably different interpretations of the world: "meaning is constructed in very different ways with alternative transcriptions of the same stretch of talk" (p13). "There are many ways to prepare a transcript and each is only a partial representation of speech" (Mishler (1986: p48)). "Any representation of a complex event such as an interview interaction will be less complex and more selective/simplified than the event itself" (Wengraf (2001: p222)). By keeping additional notes when transcribing a degree of this loss will be redeemed.

After transcription and identification of substantive statements, Gillham's (2000a: pp 63-72) classification process was utilised. Similar topics that emerged, within both interview and questionnaire responses, were brought together aiding comparisons of ideas. The grouping of substantive statements is of immense importance in a semi-structured interview. Much of the material for answering specific questions will be scattered throughout the interview. There is a need "to examine *all parts of the interview material* … to ensure that interview material relevant … has not been overlooked" (Wengraf (2001: p226; *original emphasis*)). Duplication of statements will be removed allowing insight into the true underlying meaning. This is not to say that the 'real' truth is presented. Interviewees are sense makers in themselves (Riessman (1993)).

Categories identified are simply headings in order to organise material (Gillham (2000a)). However "categories … reflect properties of the human mind. They are not 'objective' any more than human values … different people may arrive at different categories … [but] … the actual *category content statements* should be comprehensively presented" (*ibid.*: p69/70; *original emphasis*). Without this it is possible that misunderstandings may occur over the meaning of each category (*ibid.*). After analysis of both transcripts and questionnaire responses, categories have been developed as can be seen in *Table 3.7.a:*

1	Society's Perception of Auditors	The social need for the 'independent' auditor. The perception of auditors as being trustworthy.
2	The Perception of Independence	The trade off between independence and knowledge of clients. The level of understanding that society has of the extent of independence present.
3	The Profession as a Business	The extent to which the profession is viewed as professional, or contrastingly acting in a self-interested, business-orientated manner.
4	Lowballing and Non-Audit Services	The perceived level of impairment of independence when non-audit services are provided. The possibility of improvement by using a different department of the audit firm.
5	Methods of Improvements to Independence	Issues such as the rotation of auditors or the audit partner signing the audit report personally. The impact this has on perceptions of independence.
6	Enron	The extent to which the scandal has harmed public confidence in the profession.

Table 3.7.a

The categories created enable all the substantive statements, relevant to the research, to be placed as appropriate to facilitate analysis of perceptions that exist of auditor independence.

3.11 Research Limitations

This is a small-scale exploratory study, the results gained are a snapshot of a much larger picture. This does not indicate that they are not representative, only that care must be taken in using the conclusions provided.

Limited resources have been available this includes not only a time element, but financially it has been impossible to interview vast numbers over a wide location. However, telephone interviews were carried out for those unfortunately further a field that had to be included in the research for ontological reasons. The reasoning behind using questionnaires was to gain a wider picture of the public's perception of auditors.

As a researcher, it is my aim to be neutral with regard to both sides of the argument resulting in non-biased conclusions. The problem with this is that no matter how hard a researcher tries they will always be influenced by their surroundings and their embedded beliefs. Dey (2002) cites Jonsson & Macintosh (1997) who believe that it is impossible to be a "mere neutral recorder" of the way others see the world; "a story of any kind is inevitably theoretically and politically grounded" (p110).

I must also identify that I do believe that a problem does exist, although to what extent I cannot tell. The research can only help to identify if my perception is correct, or conversely if like others I may be misinformed.

Morgan & Smircich (1980) question whether it is feasible for anybody to conquer the barriers of their own subjective nature. Knowledge is processed through our minds and it follows that subjective elements must come into play. Alvesson (2003) gives the impression that such a statement, as this, should be seen in a negative light. Yet, it is my belief that the researcher's opinions or preconceptions should be shown. No matter what research is being carried out, if done correctly it should prove or disprove (perhaps question) any theories previously constructed.

Chapter Four: Research Findings

4.1 Data Demographics

Table 4.1.a summarises the participants interviewed:

The Profession		
Audit Partner	Medium Sized CA Firm	Edinburgh
Audit Partner	Medium Sized CA Firm	West Lothian
Industry		
Director of Accounting	Scottish Wholesale Retail Company	Dundee
Internal Auditor	Scottish Wholesale Retail Company	Dundee
Public (Interviews)		
Family Business Member	Travel	West Lothian
Master of Works/Estate Manager	Construction/Agriculture	Edinburgh

Table 4.1.a

In terms of responses to the questionnaires, there were two specific sets of data collected. The first considered the perceptions of students from ages 17-23, while the other group consisted of a wider age range, from a variety of positions. *Table 4.1.b* summarises these participants:

Data Set	Number of Responses
Students	32
General Public	9
Total:	**41**

Table 4.1.b

Four questionnaire responses had to be disregarded. Three were because of lack of information, many questions were not completed and the few that were consisted of 'yes' or 'no' answers. The fourth was a result of answer material having no relevance to the subject area of the research; there was a complete lack of knowledge and understanding of the topic.

As an initial exploratory study, this sample of the public (taking account of two interviews) should be sufficient to gauge the general perceptions, held of auditors. Although a large number of students were involved in this study, different backgrounds emerge with each individual having different exposures to the profession. This may be through the mass media or other connections, such as parents working in business.

4.2 Society's Perception of Auditors

Before analysing the extent of the profession's independence, it is first a requirement to understand what function 'society' sees auditors as performing. There is strong debate, as to who can rely on an audit opinion (see *Dialogue 4.2.a*).

Audit Partner	…society is not paying the auditors.
Interviewer	*The auditors are acting for society?*
Audit Partner	No. They are not. The auditors are acting for the shareholders.
Interviewer	*Shareholders as part of society?*
Audit Partner	Shareholders as shareholders…

Dialogue 4.2.a

This was obvious in one of the interviews where I was reminded in clear terms of the 'Caparo Industries plc v Dickman' case (1990) where "a duty of care is owed to third parties only when the tests of foreseeability, proximity and fairness are satisfied" (Porter *et al.* (1996: p321)). This research will not discuss the extent of liability that an auditor is perceived to have to wider society, instead focusing on personal perceptions, with the auditor as solely providing a service for the shareholder.

Overall the majority (77%) of respondents from 'society' believed that the profession was necessary and auditors could be trusted to perform their work satisfactorily:

> "Certainly … a very necessary and worthwhile job."

> "There would be numerous financial irregularities if they did not exist … accounts would not be worth the paper they're written on."

> "… regarded as a necessary evil."

It was noted by one respondent that "the trust in which they were held has almost evaporated … the profession has to work hard to restore public confidence, trust and respect". This relates to the appearance of independence issue. Auditors may be acting in an appropriate manner, but not communicating this properly. Even one of the audit partners could see:

> "There is a perception that auditors are getting a bit like lawyers or used car salesmen."

This is not to say that members of those professions should not be trusted, only that they have maintained a poor reputation for many years. A member of the public commented along similar lines:

> "Most of the solicitors and accountants are in jail!"

However, following this comment:

> "We all rely on them, it is like the doctors and teachers, we need them."

Taking these two contrasting views made by the same person shows that perhaps the public has no choice but to trust the profession. Both audit partners realised:

> "There is no alternative, so they have to accept … even though there is a huge element of doubt."

> "They can't do anything else. I don't think that it would stop them buying shares or investing."

This was also realised by some respondents:

> "… just have to hope for the best, that they are doing the right thing."

> "There are many people that would hope that they would disappear. They are a necessary evil … there are a lot that work on the shady side of the law."

Yet, the audit opinion is there to provide confidence:

> "… we are selling assurance. That is selling third party confidence … an audit firm is basically an insurance company. We are giving the directors a certificate … what we charge depends on what our estimated time and costs are in producing enough back up to that certificate."

Although there is no choice as to whether or not to trust the profession, several members of the public brought forth the idea of somebody who is professionally trained to do the job, which brings confidence.

> "Their professional opinion should be unbiased."

> "They have been trained and have the skills needed to carry this out."

Rightly or wrongly there was a perception given that the auditor is a stock-taker and that their job is to ensure that accounts are correct rather than simply provide a 'true and fair' view.

> "… they analyse and double check work."

> "… making sure your accounts are right at the end of the day … somebody with their finger on the pulse."

This suggests that many believe that a '100% bash', as one audit partner described, is always carried out. This is an incorrect view, but it is the perception that is to be realised. There is a gap of expectation between 'society' and the auditor. Nevertheless, one audit partner did realise:

> "There is an awful lot of form filling (tick-box auditing) … rather than an audit as the public would perceive – which is checking."

Although there were few responses indicating a lack of trust with the profession, those that did had strong views:

> "… a disreputable and dishonest profession."

> "[I would trust them] as much as most other 'professionals'!"

> "They are out to enhance their own careers."

In fact one of the respondents viewed that it was personal experience that harmed their perception, indicating that each professional has the ability to make impact upon the image of the whole industry. This suggests that an audit provides no value to these people; but the majority would disagree. Two main views emerged either another profession would exploit the situation or as one respondent perceived:

> "Corruption within companies could happen more as it would be harder to crack down on, not just corruption, but genuine mistakes could go unnoticed."

Conversely, two students came to the conclusion that fault did not lie with auditors for large scale failures, "companies should be trusted anyway":

> "I don't trust the company directors who are in a good position to hide items from auditors who can't check everything."

In other words auditors are easily targeted when mistakes are made, since they are covered by professional indemnity insurance.

In summary, the majority of the public believe that the profession is necessary, but there are auditors who may not be as trustworthy as others. Overall, the audit is viewed as a necessary 'mechanism of social control' (Mautz & Sharaf (1961)).

4.3 The Perception of Independence

Independence has been called into question after scandals such as Enron. But as discussed in Section 2.3, there are two levels of independence: 'real' and 'apparent'. The appearance being what society observes and formulates perceptions with.

One of the audit partners summarised a basic problem in the United Kingdom:

> "The whole setup of the United Kingdom audit machine has a fundamental problem, when you look at independence. You are auditing the client and the client is paying your fee."

as expressed by the second audit partner:

> "Independence must be called into question … [when there are] … fee pressures."

Nevertheless, each of the four interviews from the accounting side showed the importance of independence:

> "It is very important that we do get independence."

> "It is critically important in view of recent scandals."

> "… you have got to be totally independent about everything … as such you have to be not only independent but also be seen to be independent."

One audit partner expressed this in softer terms:

> "Absolutely, yes. I think that independence has degrees … independence and perception of independence … has to be tempered by a realism … [relating to fees] … there will always be an element of relationship there …"

This was further explained, with the example of government auditors who would be totally independent, the concern though would be the lack of choice and control over whether a 'good' or 'bad' auditor was appointed.

The Director of Accounting saw the position where auditors must be able to communicate with the client, while still maintaining independence:

> "… it is not a cold relationship … [and] … a difficult thing to balance."

It was considered by an audit partner that:

> "… perception has got to be as close to reality as possible … nobody should get the idea that auditors are more independent than they actually are."

This draws the realisation that auditors are not totally independent souls. They have connections with their clients, what is important is whether society understands the position.

The opinions from 'society' show the profession as successfully communicating its position. With reference to the Director of Accounting's statement, in an ideal world, auditors should be fully independent. But this is not always possible:

> "They are acting, or should be acting independently."

> "I would say that ideally that should be the case."

> "They should [be independent, but] as usual there are some problems."

One saw the need for further knowledge of the company:

> "They must have a good knowledge of the firm that they are auditing, so perhaps a relationship is needed, although this may get too close and the auditors be influenced, knowingly or otherwise."

This last assertion shows trust. Support is given on the basis that unknowing mistakes may occur. Another opinion gave a less supportive view:

> "They should be independent, but corruption is everywhere, Enron has proved this."

From the evidence obtained it appears that there is no misinterpretation of actual independence. The question remains though, as to whether this degree of independence is adequate to provide audit quality and value. Elliot & Jacobson (1998) referred to by Jeppesen (1998) believed that the profession had abandoned trying to show independence. The accountancy interviews do not sustain this to the full extent. Nonetheless, one may wonder why there is such a lax attitude to the loss of at least a portion of independence.

4.4 The Profession as a Business

There is a concern that the world of accountancy has entered the arena of big business; having commercial rather than professional concerns. The profession is considered to be using its monopoly powers to its advantage rather than serving the 'public interest'; the profession should "subordinate their self-interests to the interests of the public" (Sikka *et al*. (1989: p48)).

To analyse the extent to which business is more dominant, participants were asked if they saw problems having the Big Four, as the leaders to the profession. Emphasis was drawn on the fact that over a relatively short period of time, mergers and the demise of Andersen have resulted in fewer firms at the top.

A significant majority (68%) perceived there to be a problem:

> "… in-bred and self supporting practices become the norm."

not everybody against the Big Four, however gave such a strong response:

> "… there should be more … [creating] … healthy competition … bring prices down."

While some conceded that there was no choice but to accept the situation:

> "There will always be the big ones, in any walk of life."

Of those either in support, but certainly not against the Big Four, three responses were of specific substance. It was held that no matter the number of firms that "they will be independent":

> "They have worked hard to be the best and shouldn't be criticised for it."

> "They should be professional regardless."

On the other hand a neutral reaction was obtained:

> "This is a problem when they use their powers to influence decisions and have created monopoly positions, but it could be good as they can have standards and practices which smaller firms follow."

As identified the problem emerges when power is used for manipulation purposes. If power is used to redefine independence for self-interest, then this is undoubtedly immoral (Sikka & Willmott (1995)).

One of the audit partners openly supports this:

> "… you are going to get to the stage where the Big Four will dictate how an audit is carried out … they will make sure that they are all doing similar things."

An example of this argument is made:

> "… the big firms brought in statistical sampling … to save time and money."

The audit partner compares this practice to the perception of the public as seeing the auditor as checking everything. It is observed that:

> "If you are with a large firm you can justify anything … the large firm is always perceived to be … more professional."

Although the contradictory position was stated by the same partner:

> "… the Big Four are much more businesses than professions now."

Contrastingly the second audit partner considered that no difficulty existed:

> "We are actively trying to take clients from these big companies … it is easier for us to win over quality clients."

In support for the size of the Big Four:

> "… the external audit function should be large enough and sufficiently resourced in order to gather all the relevant information."

speaking in the context of a listed plc company.

Therefore 'society' perceives a problem to exist, considering themselves unable to act. Business has become more dominant, even accepted by the accountancy profession, with society having no choice but to recognize the situation as existing. Society is immobilized; it can't make improvements against the power of the Big Four.

4.5 Lowballing and Non-Audit Services

Non-audit services have been considered the main feature of the professional business. The view is expressed that non-audit services cause an auditor to lose independence and therefore there is a lack of value to the audit opinion. However, the commonly held conception does not stand up to detailed examination. In agreement with Jenkins & Krawczyk's (2000) analysis of Kinney (1999) there is little evidence within this research either one way or the other as to whether the appearance of independence is compromised with non-audit services. The results give a borderline split between the opposing views.

There is faith that professional integrity is present:

> "They should be able to distance themselves from both elements, but its up to the individual's integrity to maintain a professional outlook."
>
> "… an air of professionalism should be maintained …"
>
> "… different roles … shouldn't affect their interest in auditing."

In addition, advice is considered helpful and extended knowledge of the business is important:

> "… as long as they are providing advice."

> "… it is essential that they have a knowledge of the firm."

Still, one response did question how one could be sure that it was good advice.

On balance, there were similar numbers who disagreed with the provision of non-audit services:

> "They should be controlled under severe financial and criminal penalties."

> "… they might get sidetracked."

> "They should not be providing … [a] … service closer than auditing, it should be one or the other for safety and reliability."

> "… to ensure that everything is correct – no more no less."

An audit partner also held that:

> "They have got enough to do if they are doing it properly without adding bits and pieces on here and there."

Therefore a definite answer is not possible. There are two sides to this argument, both reasonable and well supported.

Non-audit services are often associated with the practice of lowballing, which is not in favour by either the public or the professionals:

> "… you would wonder about the quality of the work being compromised."

> "I would see [lowballing] as unprofessional."

> "Does that mean that Firm x is doing less work?"

> “Personally, I don’t like it.”

Though one member of the public, viewing the profession as a business commented:

> “… everybody is in business to make money … it would [not] impair independence.”

This is an interesting scenario; each of the accountancy responses viewed the practice as incorrect (quotes above), so why would somebody in the public view it as acceptable? One may wonder if there were some accountancy responses, which were tailored answers. Alternatively, perhaps only the larger firms use such practices. Compounding the idea that it is the larger firm that undermines the professionalism of the profession.

Considerable numbers indicated a comfort if non-audit services were provided by separate departments:

> “… still depends on the communication between departments.”

> “The same person should not be involved with both aspects.”

> “… although it is the same firm that is supplying the services … they are different departments … better if they are separate business units … [perhaps it would] … only impair independence when it is a smaller accounting firm who rely heavily on a few companies to make up their profits.”

Even though, one audit partner considered the situation to be difficult:

> “… human nature is that … you speak to people in the other section. If you both happen to be at the audit client at the same time, it is hard to justify that there would be total independence.”

The Internal Auditor commented that there should be no need for distinct firms:

> "… as long as you have two reports … they are professional enough."

An audit partner viewed that:

> "There should be a very clear divide."

Another issue brought up was the provision of non-audit services to the smaller organisation:

> "There is an important difference between non-audit services … in the listed and private sector."

An audit partner noted this, whereas public responses considered the same aspect:

> "They shouldn't really be advising, although especially for the smaller firm it is important to have someone to turn to."

However, one audit partner saw the problem of separation in the smaller firm:

> "… the big firms are the only ones that have that structure … you have me doing everything – that is not independent."

It appears that many of the public would agree with advice as being important; however, the main problem is how the services are provided, ensuring separate provision from audit work. There is not the impression that non-audit services provide any dilemma for the smaller business, it is the larger conglomerates that more concern exists over.

4.6 Methods of Improvements to Independence

For this research two alternative measures have been discussed which may improve auditor independence: mandatory rotation of auditors; and the audit partner being held jointly liable with the firm, by signing their name on the audit report.

One audit partner said, mandatory auditor rotation "would not be getting the same degree of attention if it hadn't been for the recent corporate scandals". The Director of Accounting additionally realised it is "a very topical issue at the moment".

Quantifying the results an unmistakable majority (66%) judged that mandatory auditor rotation would enhance audit standards. 23% were against rotation, with 11% considering that rotation would only be beneficial after a lengthy period with the one company. Auditors would not have an appreciation of the client's business by changing too often.

> "They should stay … to know how the company runs and give a good opinion."

> "The rotation should be done over a period that will allow them to know the company but not get too comfortable."

The Internal Auditor was in an equivalent mind:

> "I would say that a form of consistency over a few years is necessary … you need somebody to understand a firm's logic."

Several issues were raised in agreement with rotation, nevertheless it was considered:

> "… a good idea, but difficult to regulate especially in smaller firms. What is a good time limit?"

This explanation continued with the realisation that conflicts could emerge "if a company uses two accountancy firms e.g. one for tax and one for audit." However, rotation would ensure:

> "A higher standard of auditing."

> "Auditors [rotating] ensures an unbiased trusted opinion."

On the other hand:

> "It should be left to the firm … to make sure things are kept tight."

> "The company should keep the same auditor as they know that these auditors are reliable."

Another member of the public saw that:

> "Enforced rotation should not be necessary if the firm … is doing the job properly."

In a similar vein:

> "If it is a complex organisation … [then things may be missed if rotation occurs too often] … but surely an auditor – if they are professional, should be able to adapt."

Instead of full rotation the question of merely members of staff rotating was discussed. Firstly a member of the public considered the current practice as:

> "… almost pointless as the same firm keeps hold of the contracts."

Yet, the Internal Auditor analysed that even the team changing "would achieve a lot" compounded with the view by an audit partner that "staff get into comfort zones".

The subject of rotation was perceived by an audit partner as having little value outside the listed sector because of the "cost-benefit equation". Although the discussion continued with the presentation of the idea that there is always a form of rotation:

> "Managers … will always rotate … [they're] … very ambitious people."

Thus there is the debate that mandatory auditor rotation would have benefits provided the 'cost-benefit equation' was satisfied. Still, it is understood and accepted that an audit firm needs to have a detailed knowledge of the auditee. On an extreme level it was considered by an audit partner that government auditors would ensure total independence. Though, once more problems would emerge with the quality of the audit work. Providing the profession can satisfy the public that auditors do move around within the firm, and remain independent, then there is no requirement for rotation to be made mandatory.

The second improvement considered, of the engagement partner signing the audit report, had a balanced response:

> "To have a dual signature … would be a good thing – a double security"

While another answer from 'society' believed:

> "… just the firm should sign it; because it is a team working exercise."

This was the opinion of one audit partner:

> "Who is responsible? The firm is responsible … [do we] … toss a three-sided coin and see who signs the audit report?"

In agreement with such an improvement, the Internal Auditor saw:

> "A manager in any job is ultimately responsible … he should have enough confidence in his team."

Summarising this section, the Director of Accounting viewed the situation as being one of professional credibility, where this suggestion for improvement should not improve the auditor's opinion on financial statements.

4.7 Enron's Impact on Perceptions of the Profession

Lindberg & Beck (2002) argued that the Enron debacle in the United States has seriously dented the perception that the public have of the audit profession. While this may well be the case in the United States, participants from this study (based in the United Kingdom) do not show an overwhelming concern. Less than half of those surveyed (48%) believed that their perception of the profession had worsened after the scandal. 35% held that Enron had had no effect on them, whilst 16% responded with a lack of surprise:

> "It has harmed my confidence, but I'm not surprised."

One audit partner commented:

> "Most of my client's just find it funny!"

While the other audit partner regarded Andersen as "above everybody else … the cream of the academia", deeming that:

> "… they have been brought down to a normal level."

Further commenting and returning to the appearance issue, this may not be true but:

> "… it is the perception."

The reaction received from the Director of Accounting indicated that Enron was an American problem, unlikely to happen in the United Kingdom:

> "I feel that our standards are more robust … the US standards are open … in terms of interpretation."

A supportive student gave a similar interpretation:

> "This has changed my perception … I do not have much confidence in the American industry."

Another judged:

> "… more suspicious about auditors and how they go about their job."

Returning to the need for acceptance:

> "… that kind of thing … still does go on and will continue to go on."

> "… big business always has problems … Enron was just one …"

> "… a huge amount. You would think that there was a fair degree of dishonesty."

Yet, these people did not believe that Enron had impacted upon them.

It was also commented that Enron has brought to light problems with management:

> "Revealed the fictitious nature of business financial control."

Whereas another corroborated, in support of auditors but sceptical of company control:

> "My confidence has not been harmed for the profession, less confidence in company directors who I think should be held more responsible … if auditors have done everything possible."

Consequently, perhaps Enron can be considered to have simply brought issues of doubt over the profession to light again, without seriously impacting on individual's perceptions.

Conclusions

5.1 Answering the Research Questions

What perception does society have of auditors?

There is no doubt in this study that 'society' feels the absolute need for the service an auditor provides. Without an external body examining the accounts of a financial enterprise, it is perceived that society would lose control of those managing businesses, in which they have substantial sums invested.

Nevertheless, as Plaistowe (1992) stated:

> "Because of audit's high public profile, it is on the performance of auditors that our profession will often be judged" (Sikka & Willmott (1995: p556)).

This relates to the responses received, despite the obvious need for auditors there is an element of doubt over the trustworthy nature of auditors. One participant with a lack of faith commented:

> "I'm not convinced on the idea of auditors anyway …"

This person had been severely affected by the self-interest of one particular auditor, tainting their image of the profession. It is explicitly noticeable that one auditor can influence the perception of the whole profession.

Even though a lack of trust existed, acting in a compensatory fashion, belief in professionalism and professional training helped sustain an element of confidence. However, the lack of choice element makes one wonder if 'society' simply has to resentfully accept the profession.

Are auditors acting with an independent mind?

Independence of auditors previously was never questioned:

> "it was not that independence was not required, but in the more gentlemanly days of yesteryear it was never in doubt" (Morrison (1977) cited by Ansong *et al.* (2000: p6)).

Today there is not such a certainty on independence, although the level present is understood by society. Perception does appear to equal reality.

Still 'society' wishes to observe the profession improving its position. Non-audit services were not perceived to be a major problem. Advice is always in demand, especially for the smaller enterprise. It was deemed that enough professionalism existed on this aspect, in addition with non-audit services being provided by a different department. What impairs the perception is the business manner in which the profession operates.

The two suggested improvements to independence would both provide the appearance of improvement. However both have fundamental flaws. It is not practical for one partner to sign the audit report since it is a team-working exercise. While mandatory auditor rotation could result in a lack of knowledge of the client. The policy should not be enforced merely on political grounds, longer-term relationships are less likely to fail (Walker *et al.* (1998)). 'Society' did realise this. If rotation was implemented suggestions of periods ranging from five to ten years were considered acceptable.

Is the profession acting in a self-interested way, abandoning a duty of professionalism?

This question returns to the concept of 'lack of choice'. The profession is perceived to be a business, not subordinating their self-interests. It has been claimed that Andersen acted with management against the responsibility to shareholders (CGAAI (2003)). This is undoubtedly against the 'public interest'. It appears that focusing on the Big Four, that size does cause concern. The Big Four are using their power to influence and manipulate the definition of independence, questioning the value of an audit. The audit should not need to be the strategic necessary (Jeppesen (1998)); it should be the dominant practice with other services providing minor revenues.

What effect has Enron had on society's perception of auditor independence?

From this study it is viewed that Enron has not had a detrimental impact on the perception of professional independence. There is already scepticism of auditors. Enron has drawn attention to the profession and possibly in time:

> "people will … see … the importance of a good audit. They may have viewed an audit as a necessary evil before, but now perhaps they will see that it can bring true value to a company" (Pawlyna (2002: p34)).

If at present Enron is not viewed in a negative light, it maybe that there will be a positive outcome from the episode, if the profession improves its position, both in terms of the appearance of independence, but more especially regarding the *aura* of a profession with integrity.

5.2 The Research Aim Achieved

The aim of this investigation has been achieved, with conclusions reached on the extent to which the profession are acting in the ‘public interest’.

It has been considered that although the profession is providing a valuable service, it has an excessive tendency towards business interests. Nevertheless, initial perceptions are that it is the Big Four that are causing the majority of the concern. The perception is that they are using their ‘monopoly’ to their own advantage.

Auditors have impaired their independence to a degree, by acting in a business style. ‘Society’ realise this, but note that they have a lack of control. Auditing is necessary and should be considered of tremendous value and not as a necessary evil. However, the profession must find an approach to improve their own appearance in order for this to be accepted.

5.3 Future Research

This has been a small-scale study gauging initial perceptions of society. The results have been enlightening. As an area for future study, it would be of immense significance to obtain results from a larger sample of society, to observe if these perceptions are representative. It would also be advantageous, giving the claims made, that members of the Big Four be interviewed to respond to the allegations against them.

References

Accountancy, (2002), *"Accounting Crisis"*, August, p. 13.

Accountancy, (2002), *"Consultancy Booms, But Tough Times Ahead"*, September, pp. 13-16.

Accountancy Age, (2002), *"Auditor Rotation – New Balls Please"*. http://www.accountancyage.com/Analysis/1128069

AFRB, The Accountancy Foundation Review Board, (2002), *"Protecting the Public Interest"*, February. http://www.accountancyfoundation.com/uploaded_documents/THE_PUBLIC_INTEREST.pdf

Alvesson, M., (2003), *"Beyond Neopositivists, Romantics, and Localists: A Reflexive Approach to Interviews in Organisational Research"*, Academy of Management Review, Vol. 28, No. 1, pp. 13-33.

Alvesson, M. and Deetz, S., (2000), *"Alternative Social Science Research Perspectives" in "Doing Critical Management Research"*, Sage Publications Ltd.

Alvesson, M. and Sköldberg, K., (2000), *"Reflexive Methodology – New Vistas for Qualitative Research"*, Sage Publications Ltd.

Ansong, G., Gorman, F. B. and Hamby, W., (2000), *"Auditor Independence: Perceptions of Chartered Accountants"*, (Paper presented at the: European Accounting Congress, Munich, Germany, March 2000).

Broom, D., (2002), "*Mid-tier Bites at Big Four's Market"*, Accountancy, August, pp. 24-25

Brown, S. D., Pujol, J. and Curt, B. C., (1998), *"As One in a Web? Discourse, Materiality and the Place of Ethics"*, in: Parker, I. (ed.), *"Social Constructionism, Discourse and Realism"*, Sage Publications Ltd, pp. 75-90.

Bruce, R., (2002), *"Rotation of Auditors 'Has No Impact'"*, Financial Times, Companies & Finance International, September 17, p. 20.

Burr, V., (1998), *"Overview: Realism, Relativism, Social Constructionism and Discourse"*, in: Parker, I. (ed), *"Social Constructionism, Discourse and Realism"*, Sage Publications Ltd, pp. 13-26.

Canning, M. and Gwilliam, D., (1999), *"Non-Audit Services and Auditor Independence: Some Evidence from Ireland"*, The European Accounting Review, Vol. 8, No. 3, pp. 401-419.

CGAAI, Co-ordinating Group on Audit and Accounting Issue, (2003), *"Final Report – To the Secretary of State for Trade and Industry and the Chancellor of the Exchequer"*.
http://www.dti.gov.uk/cld/cgaai-final.pdf

Citron, D. B., (2001), *"The UK's Framework Approach to Auditor Independence and the Commercialization of the Accounting Profession"*.
http://www.business.city.ac.uk/facfin/papers/aaaj2.doc

Clough, P. and Nutbrown, C., (2002), *"A Student's Guide to Methodology"*, Sage Publications Ltd.

Crotty, M., (1998), *"The Foundations of Social Research – Meaning and Perspective in the Research Process"*, Sage Publications Ltd.

Dey, C., (2002), *"Methodological Issues: The Use of Critical Ethnography as an Active Research Methodology"*, Accounting, Auditing and Accountability, Vol. 15, No. 1, pp. 106-121.

Dickson, M., (2003), *"Accounting Reform: Cosily, Oh Cosily Does It: Some Tough Issues Evaded"*, Financial Times, Lombard/Companies & Finance UK & Ireland, January 30, p. 22.

Dunn, J. and Sikka, P., (1999), *"Auditors: Keeping The Public in the Dark"*, Association for Accountancy & Business Affairs.
http://visar.csustan.edu/aaba/dunn&sikka.pdf

The Economist, (1992), *"Accountancy – All Change"*, October 17, pp. 25-28.

Flick, U., (1998), *"An Introduction to Qualitative Research"*, Sage Publications Ltd.

Flint, D., (1988), *"Philosophy and Principles of Auditing – An Introduction"*, Macmillan Education Ltd.

Gendron, Y., Cooper, D. J. and Townley, B., (2001), *"In the Name of Accountability: State Auditing, Independence and New Public Management"*, Accounting, Auditing and Accountability, Vol. 14, No. 3, pp. 278-310.

Gilchrist, G., (2002), *"Separate Entities"*, Accountancy, October, p69.

Gilchrist, V. J., (1992), *"Key Informant Interviews", in: Crabtree, B. F. and Miller, W. L. (eds.), "Doing Qualitative Research"*, Sage Publications Ltd.

Gillham, B., (2000a), *"The Research Interview"*, Real World Research, Continuum.

Gillham, B., (2000b), *"Case Study Research Methods"*, Real World Research, Continuum.

Grout, P., Jewitt, I., Pong, C. and Whittington, G., (1994), *"'Auditor Professional Judgement': Implications for Regulation and the Law"*, Economic Policy, No. 19, October, pp. 308-351.

Grout, P., Jewitt, I., Pong, C. and Whittington, G., (1995), *"Commentary: Is Total Auditor Independence a Good Thing?"*, Accountancy, February, p75.

Haslam, J., (2001), A Discussion of "*Methods and Methodology"* with Professor J. Haslam of Heriot-Watt University, held as part of the project work in the Heriot-Watt University third year module: Management Accounting Techniques and Decisions, November 21.

Hatch, M. J., (1997), *"Histories, Metaphors, and Perspectives in Organization Theory" in "Organization Theory"*, Oxford University Press.

Hatherly, D., (1999), *"The Future of Auditing: The Debate in the UK"*, The European Accounting Review, Vol. 8, No. 1, pp. 51-65

Hermsen, M. L., Niehoff, P. J. and Uhrynuk, M. R., (2002), *"An Extraordinary Expansion"*, Accountancy, October, pp. 110-112.

Jenkins, J. G. and Krawczyk, K., (2000), "*The Relationship Between Non-Audit Services and Perceived Auditor Independence"*.
http://accounting.rutgers.edu/raw/aaa/audit/midyear/01midyear/papers/jenkins.pdf

Jeppesen, K. K., (1998), *"Reinventing Auditing, Redefining Consulting and Independence"*, The European Accounting Review, Vol. 7, No. 3, pp. 517-539.

Laughlin, R. C., (1987), *"Accounting Systems In Organisational Contexts: A Case For Critical Theory"*, Accounting, Organisations and Society, Vol. 12, No. 5, pp. 479-502.

Lee, T., (2002), *"Professional Socialisation, Commercial Pressures and Junior Staff's Time-Pressured Irregular Auditing – A Contextual Interpretation"*, British Accounting Review, Vol. 34, pp. 315-333.

Lennox, C. S., (1999), *"Non-Audit Fees, Disclosure and Audit Quality"*, The European Accounting Review, Vol. 8, No. 2, pp. 239-252.

Lindberg, D. L., and Beck, F. D., (2002), *"CPA's Perceptions of Auditor Independence: An Analysis of Views Before and After the Collapse of Enron"*.
http://accounting.rutgers.edu/raw/aaa/audit/midyear/03midyear/papers/AuditorIndep-paper1-AuditingSection.isu.pdf

Macintosh, N. B. and Shearer, T., (2000), *"The Accounting Profession Today: A Poststructuralist Critique"*, Critical Perspectives on Accounting, Vol. 11, pp. 607-626.

Mautz, R. K. and Sharaf, H. A., (1961), *"Independence" in "The Philosophy of Auditing"*, American Accounting Association, Monograph No. 6.

McKenna, C., (2002), *"Looking Forward to the Past"*, Accountancy, October, p72.

Mishler, E. G., (1986), *"Research Interviewing: Context and Narrative"*, First Harvard University Press.

Morgan, G. and Smircich, L., (1980), *"The Case for Qualitative Research"*, Academy of Management Review, Vol. 5, No. 4, pp. 491-500.

Neidermeyer, P. E., Tuten, T. L. and Neidermeyer, A. A., (2002), *"Gender Differences in Auditors' Attitudes Towards Lowballing: Implications for Future Practice"*.
http://accounting.rutgers.edu/raw/aaa/2002annual/cpe/cpe3/wed4.pdf

Oliverio, M. E. and Newman, B. H., (2001), *"Use of Audit Firm for Non-Audit Services: Is Independence Impaired?"*.
http://www.pace.edu/lubin/centers/204oliveironewman.pdf

O'Neill, O, (2002), *"Spreading Suspicion" in "A Question of Trust: The BBC Reith Lectures 2002"*, Cambridge University Press, pp. 1-19.

Parker, A., (2002), *"Accountants Split Over Reforms: Auditing Medium-Sized Firms Back Shake-Up After US Corporate Scandals"*, Financial Times, National News, July 15, p. 2.

Parker, A., (2003a), *"DTI Alarm Over Tough US Rules on Auditor Rotation"*, Financial Times, National News, January 7, p. 3.

Parker, S., (2003b), *"Nothing But The Audit: The Industry Can Maintain Transparency, Meet Regulatory requirements and Restore Investor Confidence – In A Single Step"*, Financial Times, Classified Section, February 13, p. 2.

Pawlyna, A., (2002), *"Putting the Independence Back into Auditing"*, The Hong Kong Accountant, July, pp. 30-34.

Porter, B., Simon, J and Hatherly, D., (1996), *"Principles of External Auditing"*, John Wiley & Sons Ltd.

Reeves, C., (2003), *"Sticky Trap of Services: One Lesson of Enron is that Independence in both Fact and Appearance is Essential in Non-Audit Functions"*, Financial Times, Classified Section, January 16, p. 2.

Riessman, C. K., (1993), *"Narrative Analysis – Qualitative Research Methods"*, A Sage University Paper.

Ryan, B., Scapens, R. W. and Theobald, M., (1992), *"Research Method and Methodology in Finance and Accounting"*, Academic Press Ltd.

Sherer, M. and Kent, D., (1983), *"Independence" in "Auditing and Accountability"*, Pitman Books Ltd.

Sikka, P., (2001), *"Commentary: Transparency and Accountability of the Professional Accountancy Bodies: Some Observations on the Canning and O'Dwyer Paper"*, The European Accounting Review, Vol. 10, No. 4, pp. 751-761.

Sikka, P. and Willmott, H., (1995), *"The Power of 'Independence': Defending and Extending the Jurisdiction of Accounting in the United Kingdom"*, Accounting, Organisations and Society, Vol. 20, No. 6, pp. 547-581.

Sikka, P., Willmott, H. and Lowe, T., (1989), *"Guardians of Knowledge and Public Interest: Evidence and Issues of Accountability in the UK Accountancy Profession"*, Accounting, Auditing and Accountability, Vol. 2, No. 2, pp. 47-71.

Teoh, H., and Lim, C., (1996), *"An Empirical Study of the Effects of Audit Committees, Disclosure of Non-Audit Fees, and Other Issues on Audit Independence: Malaysian Evidence"*, Journal of International Accounting, Auditing and Taxation, No. 2, pp. 231-248.

Walker, P. L., Lewis, B. L. and Casterella, J. R., (1998), *"Mandatory Auditor Rotation: Arguments and Current Evidence"*.
http://panopticon.csustan.edu/cpa99/pdf/walker.PDF

Wengraf, T., (2001), *"Qualitative Research Interviewing"*, Sage Publications Ltd.

Younkins, E. W., (1983), *"A History of Auditors' Independence In The US"*, The Accounting Historians Notebook. Vol. 6, No. 1, p1-pp22-27, reproduced in Lee, T. A., (1988), *"The Evolution of Audit Thought and Practice"*, Garland Publishing, Inc.

Zaid, O. A., (1997), *"Could Auditing Standards Be Based on Society's Values?"*, Journal of Business Ethics, Vol. 16, No. 11, pp.1185-1200.

Zeff. S. A., (1998), *"Independence and Standard Setting"*, Critical Perspectives on Accounting, Vol. 9, pp. 535-543.

Appendix A – The Story of Enron

Throughout the late 1990s, Enron was almost universally considered one of the USA's most innovative companies. At its peak, it was worth about $70bn, its shares trading for about $90 each.

All that came crashing down following a stunning $638m third-quarter loss in October 2001, after which Enron gave details of a $1.2bn charge against equity it skipped over in its third-quarter results briefing, meaning the company's value was significantly less than the number on the balance sheet. It was revealed Enron had made about a dozen 'partnerships' with companies it had created, and it used those partnerships to hide huge debts and heavy losses on its trading business.

The US Securities & Exchange Commission ordered an investigation. With the share price haemorrhaging, a rescue bid looked on the cards in November, but when that fell through, the company, in administration, made drastic job cuts before filing for chapter 11 bankruptcy on 2 December – the biggest in US history. On 1 December bonuses of more than $55 million had been written to company executives.

Auditing powerhouse, Andersen, now disintegrating, later admitted that it had shredded Enron documents following the SEC's subpoena.

Source: Accountancy, (2002), *"Accounting Crisis"*, August, p. 13.

Appendix B – The Three Dimensions of Independence

Within the bounds of these three dimensions, a number of guides or clues indicating whether there has been any infringement on his independence can be developed for the guidance of the practitioner. The following are suggested:

Programming Independence

1 Freedom from managerial interference or friction intended to eliminate, specify, or modify any portion of the audit.

2 Freedom from interference with or an unco-operative attitude respecting the application of selected procedures.

3 Freedom from any outside attempts to subject the audit work to review other than that provided for in the audit process.

Investigative Independence

1 Direct and free access to all company books, records, officers and employees, and other sources of information with respect to business activities, obligations, and resources.

2 Active co-operation from managerial personnel during the course of the auditor's examination.

3 Freedom from any managerial attempt to assign or specify the activities to be examined or to establish the acceptability of evidential matter.

4 Freedom from personal interests or relationships leading to exclusion from or limitations of the examination of any activity, record, or person that otherwise would have been included in the audit.

Reporting Independence

1 Freedom from any feeling of loyalty or obligation to modify the impact of reported facts on any party.

2 Avoidance of the practice of excluding significant matters from the formal report in favour of their inclusion in an informal report of any kind.

3 Avoidance of intentional or unintentional use of ambiguous language in the statement of facts, opinions, and recommendations, and in their interpretation.

4 Freedom from any attempt to overrule the auditor's judgement as to appropriate content of the audit report, either factual matter or his opinion.

Guides such as these should have usefulness to those who find it necessary to evaluate the degree of independence actually enjoyed by a given practitioner under specific conditions.

Source: Mautz, R. K. and Sharaf, H. A., (1961), *"Independence" in "The Philosophy of Auditing"*, American Accounting Association, Monograph No. 6., p. 207.

Appendix C – The SEC and the Sarbanes-Oxley Act

In 2000 the Securities and Exchange Commission adopted amendments to the rules governing relationships between independent auditors and their SEC clients. These rules identified nine non-audit services that are deemed inconsistent with an auditor's independence:

Bookkeeping or Other Service Related to the Audit Client's Accounting Records or Financial Statements

An audit firm cannot maintain or prepare the audit client's accounting records or prepare the audit client's financial statements that are either filed with the Commission or form the basis of financial statements filed with the Commission. (An exception includes providing services in emergency situations, provided the accountant does not undertake any managerial actions or make managerial decisions).

Financial Information Systems Design and Implementation

The auditor cannot operate or supervise the operation of the client's IT systems. However, the auditor could provide IT consulting services provided certain criteria are met.

Appraisal or Valuation Services or Fairness Opinions

Restrictions on these services apply only where it is reasonably likely that the results of any valuation or appraisal would be material to the financial statements, or where the accountant would audit the results.

Actuarial Services

Actuarial-orientated advisory services are limited only when they involve the determination of insurance company policy reserves and related accounts.

Internal Audit Services

An audit firm is allowed to perform up to 40 percent (measured in terms of hours) of an audit client's internal audit work. (This rule provides an exception for smaller businesses by excluding companies with less than $200 million in assets).

Management Functions

An auditor's independence is considered impaired when the accountant acts, temporarily or permanently, as a director, officer, or employee of an audit client, or performs any decision-making, supervisory, or ongoing monitoring function for the client.

Human Resources

An auditor is not able to recruit, act as a negotiator on the audit client's behalf, develop employee testing or evaluation programs, or recommend, or advise that the client hire, a specific candidate for a specific job.

Broker-Dealer Services

An auditor cannot serve as a broker-dealer, promoter or underwriter of an audit client's securities.

Legal Services

An auditor cannot perform services for an audit client in which the person providing the services must be admitted to practice before the courts of a U.S. jurisdiction.

Source: Lindberg, D. L., and Beck, F. D., (2002), *"CPA's Perceptions of Auditor Independence: An Analysis of Views Before and After the Collapse of Enron"*, p 6.
http://accounting.rutgers.edu/raw/aaa/audit/midyear/03midyear/papers/AuditorIndep-paper1-AuditingSection.isu.pdf

These amendments became the Sarbanes-Oxley Act, which was signed into law on July 30 2002, being an extraordinary expansion of US securities law.

Source: Hermsen, M. L., Niehoff, P. J. and Uhrynuk, M. R., (2002), *"An Extraordinary Expansion"*, Accountancy, October, pp. 110-112.