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Empirical observation of the criteria for independence in auditing: Perception of auditors and teachers

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Abstract The objective of this study is to determine the perceptions of the auditors and teachers in relation to the issue of independence in auditing. We used appropriate statistic instruments and gathered the opinions of a sample of 1275 questionnaires given to these professionals, which obtained an answer rate of 35% and correspond to 447 questionnaires fully answered. The results allow us to conclude that there are particular specificities, not very efficient control structures, profound differences regarding this concept depending on the group under study, and a set of similarities with the international research. The research is innovative, nationally and internationally, due to the richness given by the diversity of the perceptions. As for the contributions, we enhance that this is the first study with an empirical basis ever done in Portugal and that it allows us to alert the professional orders and institutions to improve the safeguard of independence mechanisms.

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1. Introduction

The perception of the different types of auditors regarding the aim of the study, as far as we know, has not been studied before and nor have auditing teachers of higher education, who have a fundamental role in teaching, been sounded. The various international studies on this theme have mainly analysed the following aspects: nomination and selection, experience of the experts who take part in the supervision and audit, corporate governance structures, independence, importance of the clients in the income structure, sanction mechanisms and auditors' integrity and competence. The

sounding of the professionals themselves has not yet been studied.

Thus, the general objective of the research is to analyse the independence of the auditors in Portugal, and how it is perceived by the professional connected with auditing and teaching. In more specific terms, the study intends to find out if, regarding independence, there are significant differences in the way that each professional group faces the auditors' behaviour in relation to independence, the control mechanisms of this attribute, and if the Portuguese auditing market promotes independence.

For this purpose we have established three hypotheses:

H1: there are no statistically significant differences in the way each professional group faces the auditors' behaviour regarding independence.

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H2: there are no statistically significant differences in the way each professional group faces the implementation of control structures.

H3: the perception of each professional group regarding the auditing market does not present statistically significant differences.

The procedure used to reach the general and specific objectives mentioned above and test the hypotheses previously defined, was creating questionnaires, which were published and received in 2010, for the auditors group (statutory auditors – ROC's, internal auditors – AI's, court auditors – ATC's) and teachers (Prof's). All the subgroups were consulted in their university, where 1275 questionnaires were sent and 521 were received, 447 of which were fully answered. We obtained therefore a response rate of 35%.

The classic and modern authors of auditing (Porter, Simon, & Hatherly, 2008, pp. 101–159; Puttick, Van Esch, & Kana, 2007, p. 142) deem independence to be a necessary albeit insufficient condition. Hence, the meaning of the term in auditing is somewhat controversial, given the existence of a number of factors that lead the public to doubt the independence of auditors: relations with the audited company and the actual organisation of the profession itself (Intosai GOV 9140, 2009, pp. 1–8; Stewart & Subramanian, 2009, pp. 3–26; Wright & Capps, 2012, pp. 63–79).

Independence, as a multidimensional concept, is connected to the provision of extra auditing services together with auditing services, a state of affairs known as joint economic production, and which has a negative impact on the perception of objectivity and independence in the profession. It is further related to the issue of auditor rotation (Bamber & Venkataraman, 2007, p. 1), with there being, in fact, legal frameworks in some countries—Italy, Portugal (Companies of public interest), United States (authors' rotation and not from auditing companies), for example – which advocate the rotation of auditors after a certain period of a mandate. This is a mechanism, according to regulating agencies, which has a positive effect on independence (SOX, 2002).

Therefore, this study can be differentiated from other research because:

- Generally speaking, and to the best of our knowledge, research on independence in auditing has largely focused on external auditors, which constitutes an excessively reductionist perspective.

Thus, the sounding of court auditors, internal auditors and teachers constitute an innovative aspect, as they offer different perspectives on the theme. In addition, it is the first study with an empirical basis ever done in Portugal.

Having outlined the central theme, the second part discusses the most relevant research related to this. The third presents the statistical methodology which aims to quantify the understanding of the different professionals involved in its practice and teaching, regarding three distinct areas: behaviour of auditors, control structures and the auditing market, which cover all the criteria used to explain the concept of independence. In the fourth section, the results are discussed, and, in the fifth and final part, we draw up

conclusions, refer to the limitations of the study and put forward suggestions for future research.

2. Review of literature

The issue of the erosion of independence has been analysed at various levels: nomination and selection of the auditors, analysis of the various individuals who are part of the auditing or supervisory committees, the influence of the *corporate governance* structures, the importance of the client in the profit structure of the auditing company, the provision of services other than auditing, the sanction mechanisms, and the auditor's integrity and competence.

Therefore, when analysing the management acts of companies, Martinov-Bennie, Cohen and Simnett (2011, pp. 656–671), Carcello, Neal, Palmrose and Shohz (2011, pp. 396–430), Cohen, Gaynor, Krishnamoorthy and Wright (2011, pp. 129–147), Chu, Du and Jiang, (2011, pp. 135–153) concluded that company bodies have an important role in the selection, nomination and evaluation of auditors, as well as in their recruitment to work in companies they have previously audited. They also suggest that the nomination of individuals who are part of auditing or supervision committees is influenced by the members of the management body, thereby concluding that the *corporate governance* structures are decisive in the pragmatic operationalisation of the concept of independence (Guo & Yeh, 2014, pp. 96–104; Karaibrahimoglu, 2013, pp. 273–284).

In their turn, Li (2009, pp. 201–330) studied the importance of clients and their relationship with the auditors' independence and suggest that there is a correlation between the global fees received by the company and its total income, which affects the auditor's opinion in relation to the company's continuity. Machado de Almeida, (2012, pp. 12–54), Benau (1998, pp. 158–167) analysed the concentration of the auditing market in Portugal and Spain and concluded that the situation promoted potential impairments in the auditing information. Furthermore, Karasu (2014, pp. 79–105), Chan and Wu (2011, pp. 176–211), and Quick and Rasmussen (2009, pp. 163–183) suggest that any consultancy provided to the audited companies can put the auditors in a position of impairment, in terms of independence, criticising, therefore, the *joint supply services*. By following this line of thought, the CPAB (2012, pp. 60–69)¹ and the PCAOB (2006)² drastically restricted situations of consultancy (Brandon, Crabtree, & Maher, 2004, pp. 89–103; Deloitte, 2008, pp. 1–8).

The environment in which the auditors operate has also been studied (Glazer and Jaenicke, 2002, pp. 329–352; Ryan et al., 2001, pp. 373–386) and the results point to an effective perception, on the part of the auditor, that the existence of sanction mechanisms is a decisive incentive for the auditors to maintain their independence, together with the risk of litigation and revision of their work by peers.

Generally, the aforementioned researchers are receptive to an approach based on the implementation of rules in relation to this issue – *rules based* – to the detriment

¹ Canadian Public Accountability Board.

² Public Company Accounting Oversight Board.

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