

# [Auditor independence – 2](https://assignbuster.com/auditor-independence-2/)

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Introduction Independence is a fundamental to the reliability of auditors’ reports. It is an attitude of mind characterized by integrity and an objective approach to professional works. A professional auditor should work both independent and seen to be so. Nowadays, but, the trend of providing non-audit services to audit clients seem to be sweeping accounting firms all over the world; impacts of independence impairment caused by this trend should not be ignored.

The Meaning of Independence The essential feature of an audit is its independence and, if an accountant performs the accountancy work and then checks it himself, this checking cannot be viewed to be an audit because it lacks independence. From ACCA’s Code of Ethics, the definition of Independence is composed of independence of mind and independence in appearance.

In general, independence means an auditor’s opinion must be based on an objective without bias and disinterested assessment of whether the financial statements are presented fairly in conformity with generally accepted accounting principles. The Importance of Independence in relation to the provision of assurance The value of audit derives entirely from its independence. Without independence, auditors’ opinions lack impacts and credibility. The relationship between the auditors and audit clients, however, gives a potential threat to the independence.

Influencing Auditors’ Reports on Clients’ Financial Position due to Conflicts of Interests: Possibilities of conflicts of interest between firms and clients, where situations such as, connections of an audit firm with associated firms, familyand other personal relationships, financial interests in audit client, employment with audit clients, provision of non-audit service to audit clients, may consequently affect auditors. Without the strength of character to withstand such pressure, auditors may be unable to express independent opinions.

Preserving Investors Confidence in the Financial Market Public confidence in the capital market relies heavily on the appearance of auditor independence. Auditor independence helps to ensure quality audits and sustain the circulations of investment with the capital market. Investor confidence is eroded if investors and other users of thefinancial statementinformation do not perceive that the auditor was independent in both fact and appearance. Giving Constructive Advice

Although there is no formal obligation, a good auditor will be anxious to offer his client assistance on improvements in the financial aspects of the business if he can give an unbiased independent opinion, where added value is brought to clients and to the wider business community. Lowering Litigations Sustaining independence enables the auditors to objectively report on True and Fair Value of any information required to be disclosed in financial accounts, of which the chances of successful negligence lawsuit to a level acceptable will be reduced.

The Nature of other services provided by the auditors In the classification from APB, non-audit services is composed of any engagement where an audit firm provides professional services to an audited client other than the audit of financial statements, and pursuant to those other roles which legislation or regulation specify can be performed by the auditor of the entity.

There are five different natures of non-audit services categorized by activities arising directly from an audit of a company’s financial statements, services required to be provided by the auditor by laws, services provided by auditors because of their familiarity with the client and, as a consequence, their ability to perform them in a timely and cost effective manner, services provided because of the pool of accounting and related financial skills available to accountancy firms, services provided because of the pool of consulting and general business skills available to accountancy firms

Critical Discussion of Ethical Code Requirements Independence is part of the accountant’s code of professional conduct. Under APB Ethical Standards the concept of auditor independence shifted in favor of objectivity and neutrality in the reporting of the financial position and the results of operations, rather thanloyaltyto a particular party. The Ethical Standards allow audit firms to offer consulting services such as internal auditing and informationtechnologybut are subject to certain restrictions, and audit firms are required to disclose fees received from auditing and all non-audit services.

However, without providing clear distinctions which makes grey area exists, the rules should err on the side of caution. Auditors and their clients are likely to continually test the limits of what is permissible, including by litigating restrictions they oppose. UK’s Combined Code on Corporate Governance only recommends that audit committees develop policies to govern the future provision of non-audit services, but does not require a pre-approval of non-audit services by audit committees.

No specific enforcement mechanism ensures that management does not become involved, directly or indirectly, in selecting auditors or determining audit fees and the scope of audit. Ethical code requirements should focus to a greater extent on the issue of to what extent client management may still be able to influence the audit fee and the scope of audit engagement. Explanation of the Current and Emerging Developments

In order to increase revenue, recently, accounting firms not only provides auditing services, other services including bookkeeping, financial information systems design, human resources and management functions, valuation, internal audit, tax, legal, investment banking services and expert services unrelated to audit, also provides. There are several reasons leading to the increasing popularity of providing non-audit service, Price Competition Auditing becomes a low-profit activity that clients increasingly search for the lowest prices and the loosest standards.

Competitive bidding in auditing created pressure to reduce audit engagement hours. To maintain overall revenues, high profitability of the numerous new consulting and other non-audit services is being offered. Horizontal Integration The rapid growth of business enterprises on a worldwide basis provided large accounting firms with an opportunity to become the preferred providers of a wide range of business services, the revenues from non-audit services for audit clients quickly outpaced the fees from auditing-only services.

Audit Effectiveness Providing non-audit services allows accounting firms to perform better audits because they can obtain a better understanding of the client’s systems, which can achieve the cost-effective goal. Criticism and Analysis of Independence Impaired by Provision of Non-audit Services The relative increase in reliance on revenues from non-audit services may have placed increased pressure on auditor independence.

The major accounting firms, seems vigorously opposed reforms to eliminate the growing conflicts of interest arising from auditing and consulting for the same client, because of economic bond which the auditor does not want to lose developed between the client and the accounting firm. In order to be more competitive, accounting firms try to reduce audit fees to attractive customers by reducing engagement hours. But this risk-based auditing approach may not detect fraudulent activities. Some auditors shifted their concept of independence to becoming trusted advisors to the client’s management.

Although acting independence in certain situations is acceptable, too often an auditor’s efforts to help management resulted in concealing true economic performance. It appeared that some auditors ignored their most immediateresponsibilityto act on behalf of third-party investors or, at a minimum, to be an objective and neutral interpreter of accounting standards. Many non-audit services evolved from requests by audit clients for additional services that their auditors seemed best suited, as well as from the special skills needed to audit new and complex business transactions.

Expanding the scope of the specialists’ activities helped firms attract and retain people with skills that were increasing important to effective auditing. Audit firms’ management consulting practices have expended far beyond the skills required for audit support and the traditional areas related to financial planning and controls. Independence questions can arise when these services are marketed to audit clients. However, it is obvious that major accounting firms keep bearing legal risks by providing non-audit services to audit clients.

Even ethical standard regarding to provision of non-audit services has been revised; firms could argue that advanced technology and improvededucationenabled accounting firms to provide many non-audit services to their current client. Conclusion and Recommendations Independence, both historically and philosophically, is the foundation of accounting profession and upon its maintenance depending on the profession’s strength and its stature.

From my viewpoint, it is undeniable that Ethical standards put efforts on monitoring auditor independence; but standing at the point of running the business, accounting firms have woven an increasingly complex web of business and financial relationships with their audit clients. The most common case of independence impairment occurs because an auditor becomes so close to the client as to be unable to function objectively. The actual cause of the independence problems, however, generally was not wanton disregard rules.

Instead, internal control problems may have caused many of the breach where the weak internal control system is unable to trace employees’ investments. Despite of regulations, area needs to be addressed to improve the auditor independence is the audit firms’ internal control systems, of which all relationships between each auditor and audit clients should be reviewed from time to time. The nature of the non-audit services providing to audit clients maybe different in different era. It appears that there is more mobility of employees and an increase in dual-careerfamilies.

In the foreseeable future, keeping prohibition on non-audit services would help medium-sized accounting firms secure additional non-audit work with major clients. On the other hand, the increasingly competitive auditing market and the complexity of international business practices may cause some auditors to reduce their focus on objective and neutral interpretation of accounting standards in favor of becoming a trusted advisor for clients. MMUBS Reference Book Graham W. Cosserat and Neil Rodda (2009) Modern Auditing, 3rd ed. , John Wiley & Sons, Ltd

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