Auditor Independence: A Qualitative Study of the Perceptions of Auditors

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Abstract

The trustworthiness of a financial audit report rests on the perception of auditor independence. However, several factors can affect those perceptions, ultimately affecting market confidence. This study aims at providing a deep understanding of auditors’ perceptions of auditor independence, particularly analysing whether and how their perceptions are affected either by the provision of non-audit services, competition, the size and tenure of the audit firm or the client’s financial condition. Qualitative research was held through semi-structured interviews. Both the provision of non-audit services and tenure have generated great consensus amongst interviewees as impacting auditor independence. Rotation and litigation exposure were mainly perceived as enhancement factors.

Keywords: Financial Auditing, Auditor Independence, Trustworthiness, Perceptions

1. Introduction

Following the 2008 financial crisis, the European Commission reformed the audit market (Quick and Schmidt, 2018). Ever since, several measures have been implemented in an attempt to achieve financial stability, with greater attention being devoted to the importance of audits in stabilizing the financial system (European Commission, 2010; Quick and Schmidt, 2018). In addition, audits play an important role on the considerations of investors and other stakeholders, as they provide an opinion on the reliability of entities’ financial statements (ibid). Therefore, by strengthening public trust, audits ultimately contribute to the orderly running of markets (European Commission, n.d.).

Nevertheless, an audit report is only valuable as long as it comprises trustworthy information (Quick and Warming-Rasmussen, 2005). Actually, the relevance of audited information depends on the belief that auditors are independent, otherwise the audit opinion will be meaningless (Quick and Warming-Rasmussen, 2005; Gul, 1989). Since the perception of auditor independence is widely accepted to increase auditor credibility (Dopuch et al., 2003), independence is required to be the unshakeable “bedrock of the audit environment” (European Commission, 2010, p. 3). However, several factors have long been suggested to affect perceptions of auditor independence (Gul, 1989). Therefore, the purpose of this study is to examine how senior auditors perceive auditors’ independence, particularly analysing whether and how these perceptions are affected by a set of variables. These variables comprise the provision of non-audit services, competition, the size and tenure of the audit firm and the client’s financial condition. Similarly, enhancement factors are also addressed.

The following section reviews the main issues believed to impact the perceptions of auditor independence. Subsequently, methodology is described, followed by an analysis of the research’s main findings. Final conclusions are then presented.

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2. Literature Review

2.1 Auditor Independence

Auditor independence can be defined as the ability to make unbiased judgements and audit decisions, free from other parties’ pressures and influences (Alleyne et al., 2006; Bazerman et al., 1997). Although some authors suggest objectivity as an equivalent concept of independence (DeFond et al., 2002), Bartlett (1993, p. 55) simplifies this notion by excluding “nonspecific terms” as integrity or objectivity and defining independence as “an unbiased mental attitude in making decisions about audit work and financial reporting”. Usually, two related dimensions of auditor independence are distinguished, namely, independence in fact and independence in appearance (Alleyne et al., 2006; Dopuch et al., 2004; Beattie et al., 1999). While the former is an unbiased state of mind that allows the auditor to withstand influences that compromise professional judgement, the latter relates to the avoidance of circumstances that would lead informed third parties to reasonably conclude that the ability of the auditor to make unbiased judgments had been compromised (AICPA, 2014).

Since independence in fact is not directly observable, Dopuch et al., (2003) highlight the impossibility to regulate an individual’s mindset in a timely manner. Instead, regulators must rely on the appearance dimension, outlining the importance of public perception (Dopuch et al., 2004). Accordingly, Shockley (1981, p. 785) states that “credibility depends ultimately on the perception rather than on the fact of independence” and Holland and Lane (2012) reinforce this line of reasoning by recognising auditor independence as a key attribute to establish confidence in information provided, and eventually, to accomplish audit quality. Moreover, DeAngelo (1981) argues that audit quality is the joint probability that an auditor will both discover a misstatement in the accounting system (conditional on perceived auditor’s competence) and report the known material error (conditional on perceived auditor’s independence) (Quick and Schmidt, 2018; Bell et al., 2015).

2.2 Threats and Enhancement Factors

Prior literature has long sought to identify the factors that may affect users’ perceptions of auditor independence. Nevertheless, it often focuses on potential threats to independence, that is, challenges and sources of pressure believed to impair auditor independence, as opposed to factors that enhance public perceptions (Alleyne et al., 2006; Umar and Anandarajan, 2004). According to Simunic (1984, p. 679) “any situation which increases the probability that an auditor will not truthfully report the results of his audit investigation can be viewed as a threat to independence”. Moreover, some assert that auditors cannot always be independent and objective, given the relationship they must maintain with their clients in order to obtain appropriate evidence and future revenue (Umar and Anandarajan, 2004). Commonly addressed factors believed to impact auditors’ independence include the degree of competition within the audit market, client size and the provision of non-audit services (NAS). Other discussed factors comprise, for instance, tenure, the client’s financial condition and opinion shopping opportunities (Alleyne et al., 2006; Beattie et al., 1999; Knapp, 1985; Shockley, 1981).

Nonetheless, several factors are argued to counterbalance threats and to improve auditor independence and objectivity as, for instance, reputation concerns and litigation exposure (Lim and Tan, 2008). Additionally, regulatory factors such as the existence of audit committees, control over the appointment and remuneration of auditors, effective discipline of companies and auditors, and strong enforcement of standards, are argued to promote perceived auditor independence (Alleyne et al., 2006; Beattie et al., 1999).

2.2.1 Non-audit Services (NAS)

Among the previously identified factors, the provision of NAS has been one of the most controversial (Gul, 1989). In fact, there is no consensus in the literature on whether rendering non-audit services influence auditors’ ability to objectively evaluate financial statements (Bartlett, 1993). Although some studies suggest a negative effect on auditors’ independence (Quick and Warming-Rasmussen, 2005; Beattie et al., 1999; Shockley, 1981), others found NAS to positively impact perceived independence (Gul, 1989). Furthermore, other researchers show no evidence or inconclusive results (DeFond et al., 2002; Knapp, 1985). The provision of non-audit services to clients raise two main concerns. One relates to a strengthened economic bond between auditor and auditee, that is, to an increased financial reliance on the client: as an unfavourable opinion can possibly compromise not only audit relationships, but non-audit relationships as well, a fear of potentially losing increased revenue may impair auditor independence (Lim and Tan, 2008; Alleyne et al., 2006; DeFond et al., 2002; Bazerman et al., 1997).
Additionally, the provision of such services, as consulting, can bias auditors’ professional judgement as they must review their own work. Actually, auditors may be motivated to ignore or conceal errors related to advisory services to protect audit services reputation (Quick and Warming-Rasmussen, 2005; Simunic, 1984; Shockley, 1981).

In contrast, the advocates of auditors rendering NAS argue that the provision of both, audit and non-audit services, may improve auditor independence (Dopuch et al., 2004). One possible reasoning follows Goldman and Barlev’s (1974) view which suggests that offering non-routine services enhances auditor singularity and value to the client, hence improving auditor’s ability to resist client pressure and, consequently, to remain independent (Gul, 1989; Shockley, 1981). Additionally, since both activities require information about the very same company, knowledge spillovers⁴ may emerge from the joint provision of services, hence increasing audit efficiency and quality (Bell et al., 2015; Beattie et al., 1999; Simunic, 1984). As advisory services are typically rendered by separate departments (Quick and Warming-Rasmussen, 2005; Gul, 1989)), clients benefit from price reductions on the basis of reduced transaction costs when acquiring simultaneously NAS from the auditor (Simunic, 1984). Notwithstanding, Quick and Warming-Rasmussen (2005) postulate that “a lack of independence can neither be justified by efficiency arguments nor by the chance of increased effectiveness in the auditing and consulting areas” (p. 153). Furthermore “improved consulting services are primarily beneficial for the auditor and the client whereas a lack of independence harms the interests of external addressees” (ibid, p. 154).

2.2.2 Competition

An intensively competitive market is usually claimed to increase auditors’ economic dependence on clients, understood as an inducement for auditors to impair their independence and report favourably in order to maintain clients (Reynolds and Francis, 2001) as they can easily obtain services from an alternative company (Beattie et al., 1999; Gul, 1989). Regardless of the reasons, either simply fees minimization or search for a more acquiescent opinion, perceived independence will be at stake as clients’ incentives or opportunities for replacement increase (Shockley, 1981). Additionally, competitive environments often lead accounting firms to engage in low-balling, that is to say, to accept unprofitable discounted fees in the early years, so to become the new auditor (Quick and Schmidt, 2018; Bazerman et al., 1997). However, by lowering fees below audit cost there is an exacerbated pressure to compromise their independence, hence, to retaining clients and subsequent payoffs from the investment (Quick and Schmidt, 2018; Bazerman et al., 1997).

Although empirical results typically support the above-mentioned insights (Knapp, 1985; Shockley, 1981), Gul (1989) found environment competition to strengthen perceived auditor independence. One possible explanation refers that as competition increases, auditors attempt to create a favourable public image, resembled to impartiality, so to retain their clientele (ibid). Finally, alongside audit market competition, auditors also come across accounting firms’ strict expectations, and failure to meet those can often lead to withdrawal (Bazerman et al., 1997). As a result, auditors must handle both dimensions of competitiveness, which may negatively impact their independence by allocating considerable attention to short-term revenue (ibid).

2.2.3 Audit Firm Size

Earlier research suggests that the size of the audit firm may impact perceived auditor independence. When compared to larger-sized audit firms, Shockley (1981) found smaller firms to be perceived as less independent (Gul, 1989; Umar and Anandarajan, 2004).

As larger firms are expected to maintain a larger clientele, it assures that no particular client is a considerable source of firm revenue because the client’s related fees constitute a smaller fraction of the company’s total revenue (Gul, 1989; Shockley, 1981). However, for smaller-size firms, the withdrawal of a single client can cause significant damages. Actually, considering substantial loss of revenue, other negative outcomes, such as personnel reductions or lower compensations, may follow (Reynolds and Francis, 2001).

Furthermore, specific characteristics intrinsic to small firms’ audit practices, as the propensity to develop more personalised services or closer relationships with clients, may induce smaller firms towards a more indulgent and favourable report (Reynolds and Francis, 2001; Gul, 1989; Shockley, 1981). Therefore, given the size of its portfolio of clients, larger firms are perceived as more independent (Reynolds and Francis, 2001).

⁴Benefits arising from interdependencies or interactions between joint provision of services (Simunic, 1984).
Moreover, following an uncovered lack of independence, the auditor’s reputation can be damaged, meaning that the broader the number of clients, the greater the risk of losing additional clients’ revenue (Quick and Warming-Rasmussen, 2005). Hence, a superior number of clients will serve as a warranty against misconducts, and consequently, as an incentive to audit independence and quality (ibid). According to DeAngelo (1981, p. 184), “the larger the auditor as measured by number of clients, the less incentive the auditor has to behave opportunistically and the higher the perceived quality of the audit”.

2.2.4 Tenure

Audit tenure has also been discussed as having a potential impact on auditor independence. In fact, some argue that a lengthy association between auditor and client lessens independence (Beattie et al., 1999). This assertion is usually explained through the notion that a long audit tenure leads the accounting firm to closely relate to its client’s management interests, hence losing scepticism by relying on their accounting practices (Quick and Schmidt, 2018; Shockley, 1981). Furthermore, after a lengthy association, a truly independent stand becomes difficult to take as the auditor becomes complacent and depends more on previous work, thus lowering his efforts and disregarding rigorous audit procedures (ibid).

On the other hand, opponents of the preceding viewpoint consider mandatory auditor rotation as detrimental to independence, i.e., that extended relationships may actually improve auditor independence (Quick and Schmidt, 2018). They argue that through audit repetition, and a subsequent improved understanding of client’s operations and processes, can easily detect accounting misstatements, thus providing a more efficient and economical service, when compared to new appointed auditors (Quick and Schmidt, 2018; Shockley, 1981). Moreover, new auditors are expected to lack firm-specific knowledge and heavily rely on management information during initial years (Quick and Schmidt, 2018). As a result, clients are anticipated to perceive long serving accounting firms as more valuable, hence intensifying auditors’ ability to resist management pressure and to remain independent (Quick and Schmidt, 2018; Shockley, 1981).

Because newly assigned auditors must handle significant knowledge accumulation in a short period of time, Bell et al. (2015) find that first-year audits are more often classified as substandard audits (Knapp, 1991). Nevertheless, their findings suggest a significant improvement in audit quality afterwards, indicating that recent audit relationships may involve a considerable learning curve, which is consistent with the need for initial auditor’s knowledge accumulation. However, their results also corroborate a decline in audit quality as tenure becomes very long.

2.2.5 Financial Condition

Knapp (1985) found auditee’s financial condition to negatively influence auditor’s ability to withstand management pressure (Beattie et al., 1999). According to the author, the healthier a client’s financial condition the lower the risk of legal exposure. Hence, the accounting firm may be less encouraged to withstand management pressure, increasing the client’s perceived ability to attain its ideal outcome (Knapp, 1985). Actually, given a client’s robust financial condition, the chance of an auditor being held responsible for a controversial decision is remote, thus impairing audit firm’s perceived independence (ibid). Conversely, when the client’s financial condition is poor, the audit outcome is unlikely to correspond to client’s preferences, as the audit firm fears an increased legal exposure (Gul, 1989).

Nonetheless, Gul (1989) found client’s financial condition to insignificantly affect subjects’ perceptions. An explanation for this finding may be the lack of awareness that auditor’s independence could be impaired on account of the client’s financial condition.

2.2.6 Opinion Shopping

Opinion shopping is usually understood as the search for an auditor willing to compromise independence and sustain a client’s accounting procedure in order to fulfil intended reporting objectives (Lu, 2006).

Even though some auditor replacements follow sound reasons, others may simply happen with the aim of finding a suitable audit opinion (ibid). Lennox’s (2000) research deduces two main findings: first, auditor switches happen more frequently after clients receive modified opinions, and second, auditor replacement increases the prospects of a change in audit opinion. Therefore, these conclusions suggest that clients effectively engage in opinion shopping practices (ibid). Furthermore, opinion shopping and resulting threats to discharge auditors may impair auditor independence, causing material misstatements to deliberately occur (Lu, 2006).
Although opinion shopping may be perceived to negatively impact auditor independence, and subsequently, audit quality, Lu (2006) shows inconsistent results, i.e., that independence is neither impaired by potential dismissals nor by opinion shopping.

In order to mitigate opinion shopping risk, debate has mostly concentrated on mandatory auditor rotation as opposed to mandatory auditor retention (ibid).

### 2.2.7 Auditor Rotation

Auditor rotation has been discussed as a means of enhancing auditor independence (Daniels and Booker, 2011). Essentially, by restricting the number of consecutive years an audit firm is allowed to assess an auditee’s financial statements, regulators expect to reduce the economic bond between the two, hence decreasing the possible impairment of auditor independence (Quick and Schmidt, 2018; Daniels and Booker, 2011). Additionally, the newly appointed auditor is expected to employ a “fresh perspective” to auditee’s financial reporting and to be encouraged to reveal possible irregularities of the previous audit firm (Quick and Schmidt, 2018). This approach could be helpful to avoid negative effects arising from lengthy auditor tenure as, for instance, complacency, reliance on previous work, lack of rigor, and reliance on clients’ integrity and accounting practices (ibid).

However, an AICPA study found audit failures to be more likely during an auditor’s initial years auditing a specific company, thus sustaining that auditor rotation can intensify the possibility of audit failures, as newly assigned auditors possibly lack sufficient understanding of the client’s business, which is crucial to identify accounting errors (Daniels and Booker, 2011). Considering that the initial knowledge accumulation investment cannot be offset within a restricted tenure, the auditor’s willingness to invest in client-specific knowledge decreases (Quick and Schmidt, 2018). Earlier research primarily suggests that auditor rotation induces improved auditor independence perceptions. Quick and Schmidt (2018) found that a lengthy tenure may compromise independence, as auditors are perceived to become complacent and depend more on prior audits, resulting in lower effort and rigor. Nonetheless, their results do not enhance the importance of client-specific knowledge for perceived audit quality. Likewise, Daniels and Booker (2011) found audit firms’ rotation policies to increase loan officers’ perceptions of auditor independence, despite not impacting their perceptions of audit quality.

### 2.2.8 Auditor Retention

Whereas auditor rotation rests on replacements, auditor retention aims at preventing audit firms’ substitution for a determined period of time (Lu, 2006).

Although rotating auditors potentially enhance auditor independence perceptions, there is no guarantee that the client will not intimidate the audit firm by threatening it with a possible discharge (Quick and Schmidt, 2018). In fact, by fearing dismissal before the rotation period ends, auditors can compromise their independence (ibid). As a result, the mandatory retention of an auditor within an explicit length of time ensures protection against management pressures, thus enhancing auditor independence (ibid). Advocators of mandatory auditor retention support their stance in the idea that it diminishes opinion shopping opportunities (Lu, 2006).

Notwithstanding, in a mandatory retention setting, auditors may become excessively confident insofar as it concerns their position. Actually, as the client must retain the auditor for a certain length of time, audit firms have economic incentives to decrease their efforts (Quick and Schmidt, 2018) as well as to impair their independence, given the opportunity to be re-assigned by the auditee (ibid).

### 2.2.9 Joint Audits

Joint audits can be described as the shared performance of audit work by two different audit firms that jointly sign the audit report (Deng et al., 2014).

Several joint audits related characteristics have been appointed as potentially improving perceived auditor independence. First, as the audit is performed by two different firms, audit fees must be shared amongst them, expectedly reducing the economic bonding it exists in a single auditor setting (Quick and Schmidt, 2018).

Also, it is easily acceptable that two auditors are more prone to withstand management pressure, hence increasing the chances of providing an impartial opinion: an improved perception of independence follows the “four-eyes principle” and related review of the other auditor’s work (ibid).
Lastly, if one of the auditors' firms is replaced, joint audit settings also mitigate the newly appointed firm's lack of client-specific knowledge in the initial years of the engagement (ibid). However, joint audits can negatively influence auditor independence perceptions, as cooperative work raises the opportunities for “free-riding” (Quick and Schmidt, 2018). Under this circumstance, one of the auditors' firms can attempt to take advantage of the other firm's work, by shirking its responsibilities and by reducing its own effort (ibid). The free riding problem may exacerbate in case one of the firms is sensibly larger than the other one: to complete the same amount of work, specifically, given the better expertise of the larger firm, the smaller one is naturally expected to take longer to finish the task (Deng et al., 2014).

3. Methodology

This study aims at providing a deeper understanding of auditors' perceptions of auditor independence, as well as the reasons behind such insights. Therefore, a qualitative research was conducted given its explanatory character which, according to Ryan (2002, p. 144), “attempt[s] to explain the reasons for observed accounting practices”, being suitable to “understand and explain [...], rather than to produce generalizations” (ibid, p. 144). Semi-structured interviews were conducted using an interview script (see Appendix A). In order to guarantee both resembled questions were asked and the flexibility to explore new ideas (Ryan, 2002) was kept, the questions were developed aiming at understanding whether previously discussed factors are perceived by auditors to impact independence, and if so, how would those materialize. The script comprised nine questions, which were further reduced to eight: as the interviews phase advanced, questions five and six turn out to merge. Auditors were contacted through personal networking, although only one was personally known. Altogether, six auditors (one assistant, two seniors, two managers and one partner), belonging to six different audit firms located in Lisbon, Portugal, were interviewed (two face-to-face and four through telephone), between October and November 2018. Of those, five either belong or belonged to a ‘Big 4’ company, and one currently belongs to a medium-size audit firm. Table I presents further information regarding interviewees and the gathering of qualitative data.

Table I: Interviews and Interviewees Data

<table>
<thead>
<tr>
<th>Interview</th>
<th>Date</th>
<th>Via</th>
<th>Duration</th>
<th>Function</th>
<th>Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interview 1</td>
<td>30th Oct.</td>
<td>Telephone</td>
<td>15 mins.</td>
<td>Assistant</td>
<td>Big 4</td>
</tr>
<tr>
<td>Interview 2</td>
<td>31st Oct.</td>
<td>Face-to-face</td>
<td>35 mins.</td>
<td>Manager</td>
<td>Deloitte</td>
</tr>
<tr>
<td>Interview 3</td>
<td>31st Oct.</td>
<td>Face-to-face</td>
<td>40 mins.</td>
<td>Manager</td>
<td>Medium Size</td>
</tr>
<tr>
<td>Interview 4</td>
<td>2nd Nov.</td>
<td>Telephone</td>
<td>10 mins.</td>
<td>Senior</td>
<td>PwC</td>
</tr>
<tr>
<td>Interview 5</td>
<td>13th Nov.</td>
<td>Telephone</td>
<td>10 mins.</td>
<td>Senior</td>
<td>PwC</td>
</tr>
<tr>
<td>Interview 6</td>
<td>14th Nov.</td>
<td>Telephone</td>
<td>15 mins.</td>
<td>Partner</td>
<td>KPMG</td>
</tr>
</tbody>
</table>

Every interview was tape-recorded and subsequently transcribed, resulting in nearly 27 pages of data. Interviews were then compiled and read several times, so that patterns could be found by meaningfully dissect and combine information (Miles and Huberman, 1994). At last, data was reflected upon and findings connected to previous literature (ibid).

4. Empirical Study

Auditor independence can be referred to as the ability to make unbiased judgements, free from other parties' influences (Bazerman et al., 1997). In this regard, interviewee 1 conceptualizes it as the ability to “issue any opinion not influenced by future developments, behaviours or any type of opinion”. Interviewee 6 stated that independence is not to have “interests in the entities we audit […] and interests can be monetary interests, can be personal, can be knowing someone in core functions in those entities”.

Alternatively, as stated by DeFond et al. (2002, p. 1250), “auditor independence is often defined as the probability that the auditor will report a discovered breach in the financial reports”. Within this framework, interviewee 2 refers that a lack of independence is a matter of omission, further elaborating: “[...] independence it exists, i.e., I do my job, no one tells me not to do this or that, I do it and I have evidence (...) the question of independence lies in the omission in the opinion, that is, I do not issue an opinion based on all the facts that I have, because there are facts that I have no interest in issuing at this moment, so I omit.”
Despite being a controversial factor among researchers (Gul, 1989; Shockley, 1981), interviewees mainly perceived the provision of NAS as detrimental to auditor’s independence. In fact, some respondents are concerned that a conflict of interests may exist when services are provided by the same entity, as the firm can take advantage and time the sale of its services. Even though proponents argue that services are usually rendered in separate departments (Quick and Warming-Rasmussen, 2005), interviewee 1 highlights that it is still the same company providing them: “Although it seems that there are two companies, one consulting and one auditing, in practice and in everyday life we are talking about the same company, the same people who share the same workplace with a common interest, and that is business [...] there is almost a conflict of interests when it comes to doing business, through the planned sale of products and services”.

Interviewee 2 added that the auditor will take the opportunity to emphasize client’s weaknesses, so that later will recommend to contract consulting services: “The auditor will analyse the company in a holistic way, that is, see the company as a whole [...] and knowing that his company also provides consulting services, will express a need, i.e., will make the company feel that there is a need to improve in certain areas”. This underlying conflict is further exacerbated as auditors have to review their own work (Quick and Warming-Rasmussen, 2005; Simunic, 1984; Shockley, 1981). Given that their professional judgment can be biased, auditors may hide errors related to other services so to protect the reputation of those (ibid). In this regard, interviewees 3 and 4 suggest:

“[...] imagine there is restructuring consulting of the client and then any conflict is detected by the audit, and it was the same company that said to do so [...] there will be a conflict. Perhaps, the [audit] opinion of the same company [...] will not be impartial”. (Interviewee 3)

“If there is a material misstatement due to professional incompetence, to a poorly provided service, there may be a tendency to protect, since it is the same company.” (Interviewee 4)

Notwithstanding, interviewee 6 has a slightly different position considering that, nowadays, the provision of NAS barely influences independence, and sustaining that “in Portugal, the maximum that can be provided of services is, normally, 30% in relation to audit services, as such, 30% has no influence”. However, this interviewee also stresses that, in the past, the discrepancy that could exist between services could lead the auditor to face more pressure as there was a strengthened economic bond: “In the past, when I could have a client in which auditing was 20 thousand and consulting was 200 thousand there could be more of a pressure [...] there is always more pressure when we depend on a non-audit remuneration”. Auditors’ economic dependence on clients is also argued to increase as competition increases. Since in a competitive market, client can easily obtain services from an alternative company, auditors can compromise independence so to retain subsequent payoffs (Beattie et al., 1999; Gul, 1989; Shockley, 1981). Interviewee 2 clarifies: “From the moment it is a business and the client have a large relative weight in the company’s sales volume and knowing that there are other competitors that can enter and are anxious to enter, it stands to reason that competition is one of the limiting factors of independence”. Moreover, the search for a more acquiescent opinion is simplified as clients’ incentives and opportunities for replacement expand (Shockley, 1981). In this respect, interviewee 5 explains how competitive environments can either cause an auditor to compromise independence or foster opinion shopping practices: “Competition wants to enter, and the client is not happy with the year’s audit. The auditor may turn a blind eye to something so that the client does not change to competition… Sometimes even the client may want to change to competition, so that competition turns a blind eye to certain situations.”

On the other hand, interviewee 6 dismisses an impact on independence, although highlighting how competitive markets can threaten audit quality: “[...] if they enter into a price war is bad, because it is not possible in face of new audit requirements, new standards, a series of additional procedures that have to be done [...] it is not possible to carry out a good quality audit”. Besides the above-mentioned factors, size has also been a subject of debate in the literature. Researchers usually advocate that larger firms are perceived to be more independent than smaller firms: the former often holds a broader set of clients, assuring that no individual client is a considerable source of revenue (Quick and Warming-Rasmussen, 2005; Gul, 1989; Shockley, 1981). As a result, a particular client is not considered as essential to a large audit firm as it is to a small firm. Interviewees 4 and 5 share this view, suggesting:

“I think smaller companies are more prone to, perhaps, try to protect their position [...] by wanting to keep the client and all, the work itself may not be done with quality or even independently”. (Interviewee 4)

“[...] small companies [...] perhaps will not want to lose [an important client] due to issues related to opinion issuance… Can lead them to circumventing some situations so not to lose the client”. (Interviewee 5)
Consideration should be given also to the intrinsic characteristics to smaller firms such as the propensity to deliver more personalized services or to engage in closer relationships with clients, can induce a lack of independence (Gul, 1989; Shockley, 1981). Despite considering small audit firms more independent than large audit firms, interviewee 2 does not neglect the previous line of reasoning, emphasizing: “In smaller companies there is the risk of proximity, i.e., between partner and client, and that is a big risk because they are often friends”. Also sustaining that small firms are more independent, interviewee 3 stated: “financial scandals were in large companies. As noted, there was no impartiality, no independence”.

Conversely to previous analysed factors, auditor rotation has been discussed as a means of enhancing auditor independence (Daniels and Booker, 2011). In fact, when questioned about tenure’s potential impact on auditor independence, subjects mostly perceived rotation as a suitable enhancement factor. Interviewees 1 and 2 assert that rotation detaches auditor and client, allowing for a greater incentive to express an independent opinion. Further, a newly appointed auditor is expected to both apply a “fresh perspective” to the auditing process and to reveal possible irregularities of the previous audit firm, hence avoiding negative effects arising from a lengthy tenure, such as complacency and reliance on previous work (Quick and Schmidt, 2018): the employment of a new perspective will enable to disrupt dependency and to prevent repetitive errors from occurring. Interviewees 1 and 4, respectively, sustain:

“Many times it is necessary to have other people looking at the same thing in order to have a different perspective on the issues and eventually disrupt a potential […] dependency between the client and the auditor […] if there are shorter terms, this connection ultimately fades away: from the moment I know I will not be able to further continue with a client, I have a greater incentive to provide a more independent opinion”. (Interviewee 1)

“[…] the reason to change […] is really not to allow repetitive errors and bring a new perspective, and even if there is a lack of independence, break with that lack of independence”. (Interviewee 4)

However, recently appointed auditors can lack sufficient knowledge of the client’s business, which is critical to identify accounting misstatements (Daniels and Booker, 2011), and if the investment cannot be offset within the limited tenure, the auditor’s disposition to invest in client-specific knowledge can decrease (Quick and Schmidt, 2018). Accordingly, interviewee 6 recognizes both the initial absence of sufficient knowledge, and the investment required to provide the newly appointed auditor with sufficient understanding of the client’s business:

“With audit firm rotation there is an additional cost to both auditors and companies, because companies will have to explain everything again when a new auditor comes, and the new auditor is always, in the first, second years, in very large institutions, a big investment, so, the auditor is assigned to a client without knowing anything […] Knows public information, but does not know anything else”.

Despite rotation’s potential as an enhancement factor, there is no guarantee that the client will not intimidate the auditor with a possible discharge before the rotation period ends (Quick and Schmidt, 2018). Therefore, as audit firms can compromise their independence by fearing dismissal, mandatory retention is suggested as a means to ensure protection against management pressures (ibid). Interviewee 2 highlights:

“[…] if there is no retention […] [the auditor] knows he can leave every year. He may have a single term of five years but knows that if he does not express […] [a particular] opinion, he can leave after one year, so he is always constrained in his opinion. Additionally, as auditors’ dismissal threats can also arise from opinion shopping practices, some support mandatory retention so to lessen this kind of opportunities (Lu, 2006; Lennox, 2000)”.

In addition, interviewee 4 illustrates: “[A client] used to work with a small auditor that did not persisted much with certain aspects, suddenly gets a big company with greater experience, or another kind of tests, whatever the reason, that starts to find some errors. That can never be a reason to change […] To guarantee service’s quality, and that the reason to change is a proper reason, and not simply because the auditor is being much more annoying than the other, I think it is good to have retention”.

Similarly, some joint audits’ characteristics, as the “four-eyes principle” and the review of the other auditor’s work, have been suggested as improving audit opinions’ impartiality (Quick and Schmidt, 2018). Accordingly, interviewee 5 perceives an improved independence, as auditing “would not be confined to methodologies from the same company”. Although assuming “[a joint audit] brings neither gains nor losses”, interviewee 4 further recognizes “it brings two viewpoints”.

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Conversely, interviewee 3 questions the joint application of methods and cooperative work’s efficiency, considering that “where two work policies are joint, two mentalities, two different entities” it would not work, justifying “I do not know a single auditor who speaks well of another auditor’s work, I do not see an auditor reading another’s opinion and saying: Good job!” Interviewee 6 perceives “no great advantage” in joint audits as “[the auditors] will not be doing the same thing, they will end up dividing tasks”, and alike interviewee 3, acknowledges interpersonal relationships as an additional constraint: “The Parmalat case happened exactly because there were several auditors involved, so the communication between them was not fantastic. When we have large groups in which some are here, and others are there, communication turns out not to be as good as if it was always the same auditor, the same company”.

Although not establishing a direct connection between an auditee’s financial condition and an auditor’s independence (Beattie et al., 1999; Knapp, 1985), some interviewees perceived a higher risk of legal exposure - associated with poor financial condition (Knapp, 1985) - as likely to enhance auditors’ independence. Interviewee 2 states that “[if] the company is subject to huge legal regulation […] the auditor is much more careful […] because the auditor is more exposed". Moreover, and further mentioning reputation concerns, which may arise from litigation exposure, interviewees 1 and 4, respectively, pointed out: “It can affect in the positive sense […] a greater likelihood of facing legal issues in the future can lead to a greater independence and transparency in the auditor’s work, due to the very consequences that arise from legal exposure. At the end of the day we are always talking about a brand reputation issue to the market”. (Interviewee 1)

“[…] if there are legal issues, the ability to remain independent is even greater, I think it increases, because the auditor’s risk is higher, the auditor has his company’s name and his own to defend […] in that case independence increases”. (Interviewee 4)

5. Conclusion

This study sheds light on how auditors perceive auditor independence, clarifying and providing a deeper understanding of auditors’ insights on a set of variables, which have long been discussed in the literature to impact independence. Both, the provision of NAS and the tenure of the audit firm have generated great consensus among interviewees. These factors were mainly perceived to negatively impact independence. Regarding tenure, auditors instinctively mentioned rotation as an enhancement factor. Litigation exposure was also perceived to improve independence. Because of the study’s qualitative character, no statistical generalizations can be made out of it. Besides, along with a small sample size, the study attempted to analyse and cover several factors, which may have contributed not to extensively address all topics. Nonetheless, the selected method was aligned with the purpose of the research, which can further be extended either to exploit other factors or the perceptions of different subjects. Additionally, the unavailability of audit companies to cooperate with the investigation has proven to be a challenge. Hence, as data gathering relied on personal connections, several limitations followed. First, as a few interviewees were no longer auditors, some answers may not reflect recent audit modifications, as respondents may not be aware of existing Portuguese legislation. Therefore, some bias may arise when considering results within a national context. Actually, as the study was meant to provide a broader perspective, a Portuguese sample may present itself a limitation, as auditors’ perceptions can be influenced by, among other factors, specific national professional standards.

Finally, the study turns out to complement perspectives of professionals both at different career stages and of different companies. In this regard, it would also be interesting to investigate whether auditors’ perceptions of independence would differ in accordance with their functions or between small and medium-sized enterprises and ‘Big 4’ companies.

6. References


7. Appendices

Appendix A: Interview Script

1. Briefly, what does it mean to you to be independent in auditing?
2. Do you think the provision of non-audit services, as for instance, consulting services, can influence auditor independence? How?
3. When it comes to competition, in what way do you believe it can affect independence?
4. In comparison to small firms, do you perceive big audit firms as more independent? Why do you think is that?
5. What is your opinion towards lengthy audit tenure? In what sense is tenure good or bad?
6. How do you feel towards auditor rotation? Do you think it can improve independence?
7. What about auditor retention? Do you think it can influence independence?
8. In the event of a joint audit, what would you expect regarding independence?
9. Can you establish a connection between a client’s financial condition and the ability of the respective auditor to remain independent?

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