Perception of Auditor Independence among Auditors and Financial Statement users in Sri Lanka

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Extended Abstract

Auditor independence (AI) is a topic that is being discussed throughout the world as an important aspect. As noted by Vanasco, Skousen and Santagato (1997), AI is both an ethical and a professional issue, crucial to auditors. Independence has been viewed as “a deeply felt professional credo”. According to Carey and Doherty (as cited in Vanasco, Skousen and Santagato, 1997) there are three meanings of AI: First, in the sense of not being subordinate, it means honesty, integrity, objectivity and responsibility. Second, in the narrow sense, in which it is used in connection with auditing and expression of opinions on financial statements, independence means avoidance of any relationship which would be likely, even subconsciously, to impair the objectivity as auditor. Third, it means avoidance of relationships, which to a reasonable observer would suggest a conflict of interest.

Third party users expect the auditor to find and report all problems with the financial statements while management wants the auditor to ignore financial statements manipulation. Thus, at times, the auditor needs to choose from these conflicting needs. The auditor’s role conflict may negatively impact the auditor’s independence and the ability to conduct a just audit. If the auditor tries to be adamantly ethical in a situation of conflict, management may seek to replace the auditor. As a result, the auditor may buckle under management’s pressure, resulting in a compromise of AI (Alleyne, Devenish and Alleyne (2006).

Independence is critically important to an auditor as it is regarded as being one of the fundamental principles underlying the auditor’s work. The financial markets must have confidence in the integrity and objectivity of auditors. Without definite independence, audits have little value. Recently, researchers, regulators and the public have been concerned about AI in the current audit environment where severe audit failures like Enron and WorldCom, have emerged. Independence has been the focus of almost constant controversy, debate and analysis (Law, 2008).

Discussion on AI evolves around another two forms: “independence in fact” and “independence in appearance”. The former requires auditors to form and express an

opinion in the audit report as a disinterested and expert observer, uninfluenced by personal bias during the audit engagement, while the latter expects auditors to avoid situations that might cause others to conclude that they are not maintaining an unbiased, objective attitude of mind (Hudaib and Haniffa, 2009).

An audit report is only beneficial if it contains reliable and unbiased information audited by independent auditors. Once an auditor is perceived to lack independence, the audit work loses credibility and the value of the auditing function is severely impaired, if not lost (Firth, 1980). As a result, users will have less confidence in the financial statements. Therefore, the future of the auditing profession is argued to be dependent upon the perceptions of AI (Koh and Mahathevan; DeFond et al.; as cited in Law, 2008).

Thereby the present study attempted to investigate the appearance standard, by empirically exploring both auditors' and users' perceptions of AI and to identify the nature of the AI in Sri Lanka, while contributing to the existing knowledge about the factors that will have a threat on AI and the factors that will enhance the AI specifically in the Sri Lankan context. The problem statement of the study was "what are the factors that affect the perception on 'AI' in Sri Lanka?" It is a known fact that developing countries like Sri Lanka are deficient in research on this contentious issue, even though they too have issues related to AI.

The conceptual framework of the study consisted of seven independent variables and one dependent variable, where the independent variables were Economic Dependence on the Client, Competition in the External Audit Market, Provision of Non Audit Services (NAS), Existence of Audit Committees, Reputation of the Client (Size, Status), Risk to Auditor Arising from Poor Quality Audits and Tenure with the Client. The dependent variable was the perception on AI.

The research was carried out in a quantitative method, specifically through a questionnaire survey. In addition, interviews and perusing the documents of regulatory bodies related to Auditors were used by the researcher.

The sample was selected to represent both the users of audit reports and the auditors who audit the financial reports. It mainly comprised of groups such as auditors, financial directors, credit managers, investment analysts, and fund managers. Convenience sampling method was used, but the sample comprised approximately equal participation from the users and auditors at this stage of the study. The researcher gathered data from a total of 72 respondents for the research.

The survey instrument was divided into two sections, where section 1 dealt with demographic and background information including member status (auditor or user), gender, job title, qualifications, years of experience, age and the number of accounting courses completed. And the section 2 dealt with the concepts and variables related to AI. The response options were completed in the form of a five point Likert scale, where the wording in the five points was as follows: seriously weaken independence; slightly weaken independence; no effect on independence; slightly enhances independence; and strongly enhances independence. In analyzing the data gathered the researcher used quantitative methods of analyzing data, using the SPSS software. The responses were ranked and also the correlation between each of the independent variables and the dependent variable was measured in arriving at the final conclusions.

The respondents were mainly from two categories as auditors and users. The auditors were of the view that they are always trying to become independent in any circumstance. The results from the two groups were not contradicting and it was found that the factors that enhance AI will have a positive effect on perceived AI, which includes concepts such as, the competition among the audit firms, the existence of audit committees, the reputation of the client, and risk the auditor has due to poor quality audits. In addition the factors that hinder AI have a negative affect on perceived AI, which includes concepts such as, the economic dependence on the client, provision of NAS, and the long tenure with the client. Based on the findings of this study, the researcher is on the view that, the policy makers, mainly the Institute of Chartered Accountants of Sri Lanka (ICASL), who is the main regulatory body involved in the AI issues can introduce new paragraphs to the code of ethics of the members of the ICASL in order to enhance the level of AI in Sri Lanka. The study identified the manner in which the users of the financial statements perceives on what AI is, and thereby it can be incorporated when deciding on the guidelines and policies for auditors to minimize the issues arising due to the perceived AI.

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Factors Leading To CSR Reporting: A Case From Manufacturing Sector In Sri Lanka

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Abstract

"Corporate Social Responsibility (CSR) reporting originated from a growing stakeholder awareness of the role of business entity in the society. It is a voluntary form of self-regulation that aims to undertake everything from human rights and labour standards to limiting carbon dioxide emissions that lead to climate changes (Doane, 2004).

There are number of studies which emphasize the development of CSR reporting worldwide (Boesso & Kumar, 2006; Enquist, Johnson & Skalan, 2006; Nielsen & Thomsen, 2007; Ratanajongkol & Low, 2006; Slater & Gilbert, 2004; Tilling & Tilt, 2009). World Bank Report (2004) reveals that 45 percent of the world's largest firms produce some form of non-financial report, compared to 35 percent level of these firms in 1999. Ratanajongkol & Low (2006) found that in 1993, 13 percent of the top 100 firms in the world produce health, safety, or environmental report. By 1996, that number had risen to 17 percent, in 1999, 24 percent of firms produced CSR or Sustainability Reports, and by 2002, it was 28 percent.