Non-Audit Services and Auditor Independence
The Case of Saudi Arabia

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بسم الله الرحمن الرحيم

و الحمد لله رب العالمين

و الصلاة و السلام على خاتم الأنبياء و المرسلين

In the Name of Allah,

The Compassionate, the Merciful,

Praise be to Allah, Lord of the Universe

and

Peace and Prayers be upon His Sealed of Prophets and Messengers

Declaration

'I, Abdulaziz Al-Eissa, declare that the PhD thesis entitled Non-Audit Services and Auditor Independence: the Case of Saudi Arabia is no more than 100,000 words in length including quotes and exclusive of tables, figures, appendices, bibliography, references and footnotes. This thesis contains no material that has been submitted previously, in whole or in part, for the award of any other academic degree or diploma. Except where otherwise indicated, this thesis is my own work'.

Signed --------------------------------

(Abdulaziz Al-Eissa – Candidate)

Date -----------------------------------

Dedication

This thesis is dedicated with all my love and respect to my parents, my brothers, my sisters, my wife, and my beloved child Ibraheim.

Acknowledgments

I am grateful to Allah almighty for his guidance and blessings of my efforts during the course of this study.

This thesis would not have been possible without the support and encouragement of a number of individuals who have made invaluable contributions to this thesis.

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Abstract

The nature of the client-auditor relationship is a critical issue for stakeholders and other users of the audited financial statements. This type of relationship is predicated on trust; however, it is susceptible to differing motives, conflict of interest, and information asymmetries. An external auditor's independence is crucial to users of audited financial statements. A number of factors may impact the independence of the external auditor. This study investigates stakeholders' perceptions of NAS on auditor independence in Saudi Arabia, where NAS is banned except tax and zakat service.

This study adopted the framework developed by the Independence Standard Board (ISB) *Statement of Independence Concepts: A Conceptual Framework for Auditor Independence*, which identified five types of threats, four of which occurs when auditors provides NAS for their audit clients. A mail questionnaire method was used to collect the data. Participants were divided into six groups: major audit firms; minor audit firms; loan officers; financial analysts; financial directors; and academics. Non-parametric statistical tests were used in this study, including the Kruskal-Wallis Test and the Mann-Whitney Test, to draw inferential conclusions regarding the data collected.

Findings show that participant categories differ in their views on legalising NAS for Saudi auditor clients. While minor audit firms, financial directors, and academics supported the joint provision of audit and NAS, the other three categories did not. This result was supported by the second hypothesis, where the minor audit firms viewed that auditor independence with NAS can be maintained. In addition, all participant categories agreed that the joint provision enhances audit quality.

Furthermore, participant categories were divided about the effectiveness of the total ban of NAS. However, all groups agreed that certain procedures can be undertaken to enhance auditor independence. These procedures are: separation of personnel; disclosure of fees; and limiting recruiting services.

The familiarity threat was selected by the academic group as the greatest risk to auditor independence while the self-interest threat was selected by the other five categories.

Conclusions of this study are that NAS could be extended in Saudi Arabia, with the exception of NAS with proven risk to auditor independence. The nature of the NAS relationship should be clear and pre-approved by the client, and NAS fees published. Further, audit firm personnel undertaking NAS must be separated from the firm's auditors at all times during the procedures .

Figure Listing

Table Listing

Chapter 1 Introduction to the Thesis

1.1 Introduction

The nature of the client-auditor engagement is a critical issue for stakeholders in audited financial documentation, such as investors, creditors, and regulators. Principal-agent relationships such as client-auditor are predicated on trust; however, they are susceptible to differing motives, conflict of interest and information asymmetries. Those who rely on audited documentation for decision-making should actively understand the relationships that can occur between auditors and principals (Antle, 1982).

The importance of an impartial external auditor can be explained by the conflict arising from the separation of control from ownership. This conflict occurs when a company's management is forced to choose between satisfying their self-interest against the interests of their shareholders, especially when the two are incompatible. Thus, the external auditor should add credibility to the financial statements of a company.

An *audit expectations* gap, that is, the gap between stakeholders' expectations from auditors, and auditors' objectives in presenting a completed audit, comprises a large presence in the literature over the past few decades (e.g., American Institute of Certified Public Accountants (AICPA), 1978; Porter, 1991; McEnroe & Martens, 2001). Many studies across the world recognise this gap (e.g., Harris & Marxen, 1997; Epstein & Geiger, 1994; Porter, 1993). Auditor independence is an essential element of this expectations gap (Beattie, Brandt & Fearnley, 1998). It is also the cornerstone of the audit function (Lowe, Geiger & Pany, 1999). Identifying the auditor-client relationship is another major presence of the literature (e.g., Knapp, 1985; Beattie, Brandt & Fearnley, 1998). As such, auditor independence gives the public assurance that the audited financial statements are reliable and trustworthy. This logic cannot exist unless rational financial statement users perceive auditors as independent and expert professionals who have no interests in their audit clients (Securities and Exchange Commission [USA SEC], 2000). Thus, the main goal of independence is *to support user reliance on the financial reporting process and to enhance capital market efficiency* (Independence Standards Board [USA ISB], 2000, para.8).

In general, there are two types of auditor independence: independence-in-fact, and independence-in-appearance. The first, which is also called actual independence, can be defined as the auditors' abilities to make objective and unbiased audit decisions (Dykxhoorn

& Sinning, 1982); whilst the latter refers to the financial statements users' perceptions of the auditor independence. The importance of considering independence-in-appearance occurs due to the general realisation that independence-in-fact is impossible to be assessed by the financial statements' users (McGrath et al., 2001). Although auditors can act independently in fact and issue unbiased audit reports, the financial statements' users may expect auditors' attributes to include independent-in-appearance.

Auditor independence can be affected by factors and activities that create threats, or risk, to auditor independence; and there is general agreement on possible risks to auditor independence. These factors are classified by Johnstone, Sutton, and Warfield (2001) as direct and indirect factors; others as economic and non-economic factors (e.g., Arruñada, 1999a). The provision of non-audit services (NAS) is an example of a potential threat to auditor independence.

The joint provision of audit and NAS and their impact on auditor independence is a critical issue (Pany & Reckers, 1984). While some countries prohibit auditors providing selected NAS to their audit clients, Saudi Arabia prohibits NAS other than tax and zakat (tithes) services, arguing that full NAS provision may impair auditor independence (Firth, 2002). The extensive literature findings on the NAS issue are inconclusive, there is no agreement whether the provision of NAS strengthens or weakens auditor independence (e.g., Shockley, 1981; Canning & Gwilliam, 1999). These studies show a lack of agreement within the accounting profession commensurate with that found for financial statements' users and other stakeholders.

In addition, public expectations of the audit function and of auditor independence are extremely important to regulatory organisations (SEC, 2003; Riesenberg, 2002). After a series of regulatory failures, the United States, through the Sarbanes-Oxley Act 2002, established further control measures for audited financial statements, expanding their requirements for disclosures by companies of NAS provided by auditors and prohibiting certain forms of NAS (ibid.).

1.2 Statement of the Research Problem

Due to the separation of ownership and management through the company structure, the latter is responsible for the financial statements that explain the company's current position and past financial performance. Independent external auditors provide assurance against fraud and deliberate misrepresentation of the financial information. This permits stakeholders, including users of the financial statements, to rely on the company's financial statements for their decisions.

The New York Stock Exchange (NYSE) eighty years ago required its listed companies to obtain independent audits (Baker, 2005). In Saudi Arabia, the *Companies Act 1965* requires that joint stock companies[1] and limited liability partnerships audit their financial statements by means of an independent auditor. Further, ethical considerations emerge as an issue for the auditing profession. Researchers and audit practitioners are concerned about propriety, especially issues related to auditor independence (Lowe & Pany, 1995). Stakeholders in financial information now rely on the auditor's reputation, auditor competition, and various indicators of independence related to the provision of NAS that are investigated in this study (Firth, 1997a).

Financial Interest The provision of NAS to the audit client may increase the dependency of the audit firm upon that client. As a result, shareholders and other stakeholders may perceive auditor independence to be impaired (e.g., Firth, 1997b; Pany & Reckers, 1984). This can occur where auditors are reluctant to disagree with the client's management.

Self-Review The second indicator is that auditors providing NAS may review their own work, thus creating a conflict of interest.

Advocacy When providing NAS for an audit client, such as tax or zakat services, auditors act in support of their tax client. Hence, a conflict of interest may arise when an auditor provides both audit and NAS.

Familiarity The fourth indicator is the nature of the relationship between the auditor and the client through NAS, to the level when the auditor relies on the management's decision. The increased trust between the auditor and the management of the audit client may threaten the auditor's independence.

The public disclosure of the types of NAS utilised by a public company and relevant fees the company pays in relation to NAS and audit are not available in many countries. This lack of disclosure makes it difficult for shareholders and other users of financial statements to judge the independence of the external auditor in terms of the joint provision of audit and NAS for the same client. It also limits the opportunities available to researchers in this area. In the case of Saudi Arabia, the provision of NAS (other than tax and zakat services) for the

[2] Organisations that are part public and private ownership

audit client is banned by the professional body of accounting and auditing, Saudi Organisation for Certified Public Accountants (SOCPA), and also by the *Companies Act 1965.* However, Hudaib (2003) reported that despite the prohibition, and due to the small number of Saudi accountants, external auditors provide an extended range of NAS for their audit clients.

In addition, prior studies in auditor independence show that perceptions of independence vary between stakeholders' groups: auditors; investors; creditors; managers; and others (Jenkins & Krawczyk, 2002; Agacer & Doupnlik, 1991). Consequently, an assumption of homogeneity in auditing practices, and thus perceptions of auditor independence are challenges.

A key motivation for this study is the growing concern regarding the increase of NAS fees relative to audit fees, especially for the minor audit providers, and its impact on auditor independence (Cahan et al., 2008). While prohibiting NAS can address auditor independence, researchers assert that preventing auditors from providing NAS to their audit clients may have an adverse effect on the audit profession in terms of knowledge and skills and, as a result, audit quality (e.g., Arruñada, 1999a; McNamee et al., 2000; Joe & Vandervelde, 2007). Furthermore, regulators in some developed countries that allow NAS, such as the US, UK, and Australia, have begun to reconsider the issue of allowing auditors to provide NAS for their audit clients; therefore, there was a ban to some of the non-audit services that auditors can provide to their audit clients due to the belief that providing certain types of services may impair auditor independence. Hence, it would be feasible to know the opinion of those concerned individuals about the impact of the joint provision on auditor independence in an environment where such joint provision is already banned, except for tax and zakat service.

Moreover, while there are some studies examining factors perceived to impair auditor independence (e.g., Gul, 1989; Craswell, 1999), there are few studies exploring factors perceived to enhance auditor independence, particularly in Saudi Arabia. Finally, financial, environmental and human factors influence the perceptions of auditor independence held by both auditors and the users of their reports. In a country where religion has a very important influence on human behaviours, Saudi Arabians are influenced by their religion (Islam) and the Saudi Arabian environment is subject to conflicting ideologies: free market capitalism and *Shariah Islamiah* (Islamic Law), typified by the latter banning the collection of interest (*Reba*).

1.3 Research Objectives and Questions

The objective of this study is to investigate different stakeholders' perceptions of auditor independence in Saudi Arabia, where certain NAS are banned. This is achieved by first examining auditor and stakeholder groups' perceptions of the effects of NAS on auditor independence; second, investigating stakeholder groups' perceptions to factors which could be instituted to enhance auditor independence; and third, investigating stakeholder perceptions regarding factors that may create threats to auditor independence.

Thus, four research questions advance this study.

Q1: How do stakeholder groups differ in their perceptions regarding the effect of NAS on auditor independence?

Q2: How do stakeholder groups differ in their perceptions regarding the effect of NAS on audit quality?

Q3: How do stakeholder groups differ in their perceptions regarding the efficacy of safeguards to improve auditor independence?

Q4: How do stakeholder groups differ in their perceptions on the threat with the greater impact on auditor independence?

Whilst the objectives of this study are to identify users' perceptions of the effects of the provision of NAS on auditor independence, the intention of this researcher is to add to the body of knowledge in a wider sense. Over the last decade, a seismic shift in auditing practices occurred. First, accounting firms which specialised in auditing broadened their services to encompass financial and management functions, providing in-house consultants and services to clients and blurring the interface between corporate responsibilities. Governance of these hybrid activities by world authorities and professional bodies was graphically exposed through the Enron/Andersen affair in 2001 and the world financial crisis of 2008, although the latter is external to the timeframe of this work. Nevertheless, Saudi Arabia's oil economy is subject to the extreme pendulum effects on resource prices arguably driven by the new money market models. The Kingdom's emerging governance structures must be equal to these internal and external events. As the Saudi government is still absorbing international monetary and professional standards, the effects of further change to its regulations should be examined and reported. Thus the aim of this study is to both add its voice to the critical analysis of audit governance, and to identify and comment on the extant and predictable effects to Saudi financial security. Given that it is an Islamic society using Shar'ia and secular administrative structures, this thesis is relevant also to Arabic and other societies, in particular, those of the Gulf Cooperation Council.

1.4 Conceptual Framework

Independence is an abstract concept, and it is difficult to define (Schuetze, 1994 p.69). Nevertheless, in defining auditor independence, the literature selects objectivity, the ability to avoid biases; and integrity, willingness to report a truthful opinion that reflects the matters discovered during the audit (DeAngelo, 1981b). The US Independence Standard Board (ISB 2000) set principles for audit independence stakeholders on their decisions:

- types and significance of threats to auditor independence.
- types and effectiveness of safeguards.
- that the benefits from reducing independence risk should exceed the costs of imposing safeguards.

1.4.1 Non-Audit Services

Non-audit services (NAS) are defined as all services provided by an auditor that are not considered as an audit. Such services may be management advisory services (MAS) and compliance-related services (tax and accounting services). These services can be provided by the incumbent audit firm or an external audit firm. The research on auditor independence under these conditions identifies the following issues: providing NAS to an audit client may impair or be perceived to impair auditor independence (e.g., Shockley, 1981; Knapp, 1985); alternatively, NAS enhance auditors' knowledge of the client and thus objectivity, and independence should increase (e.g., Jenkins & Krawczyk, 2002; Lennox, 1999); lastly, NAS is not proven to have an effect on auditor independence (e.g., Barkess & Simnett, 1994; Pringle & Bushman, 1996; Hussey, 1999).

Risks to auditor independence are caused by various types of activities, relationships, and other circumstances (ISB, 2000). Understanding the nature of those threats and their potential effect on auditor independence assists decision-makers. The provision of NAS to an audit client may cause an apparent threat to auditor independence. Regulators identify five types of threats, four of which are related to the provision of NAS[2]. The four types of threats, shown in Figure 1, Threats to Auditor Independence, include:

- self-interest threats: financial relationship between auditors and clients.
- self-review threats: auditors reviewing their own work.
- advocacy threats: auditors advocating on their audit clients' position.
- familiarity threats: relationship issues with the audit and NAS contracts.

Figure 1.1 Threats to Auditor Independence illustrates these activities.

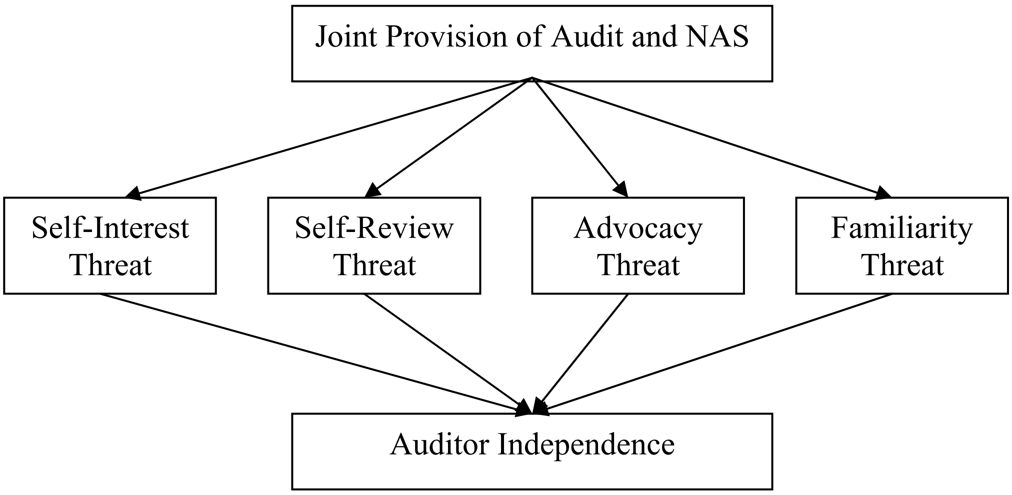

Figure 1.1 *Threats to Auditor Independence (ISB 2000)*

The provision of any of these NAS for an audit client *may* cause risk.

1.4.2 NAS Enhancements

Safeguards to auditor independence reduce threats to auditor independence. According to the Statement of Independence Concepts (ISB, 2000), safeguards include prohibition, restrictions, disclosures, policies, practices, standards, rules, institutional arrangements, and environmental conditions. Implementing such safeguards should improve the perception of auditor independence by stakeholders because such safeguards can contribute to the reduction or elimination of threats to auditor independence.

Moreover, authors investigating the effect of the provision of NAS on auditor independence do not specify common types of safeguards to enhance auditor independence

[2] The fifth type of threat is overt or covert intimidation of auditors by clients or other interested parties.

(e.g., Mayhew & Pike, 2004); however, they suggest safeguards that could enhance auditor independence, such as audit and NAS fees disclosure. The majority of those authors did not support a complete ban of all NAS, as prohibition may cause an adverse effect on audit quality.

1.5 Research Design and Methodology

Based on the literature, four gaps in NAS research were identified: the few studies investigating NAS in various environments did not achieve similar results; and further, they lacked results on factors perceived to enhance auditor independence. It is intended that the findings of this study help address such gaps and answer the research questions. Figure 1.2 Research Process illustrates this methodology.

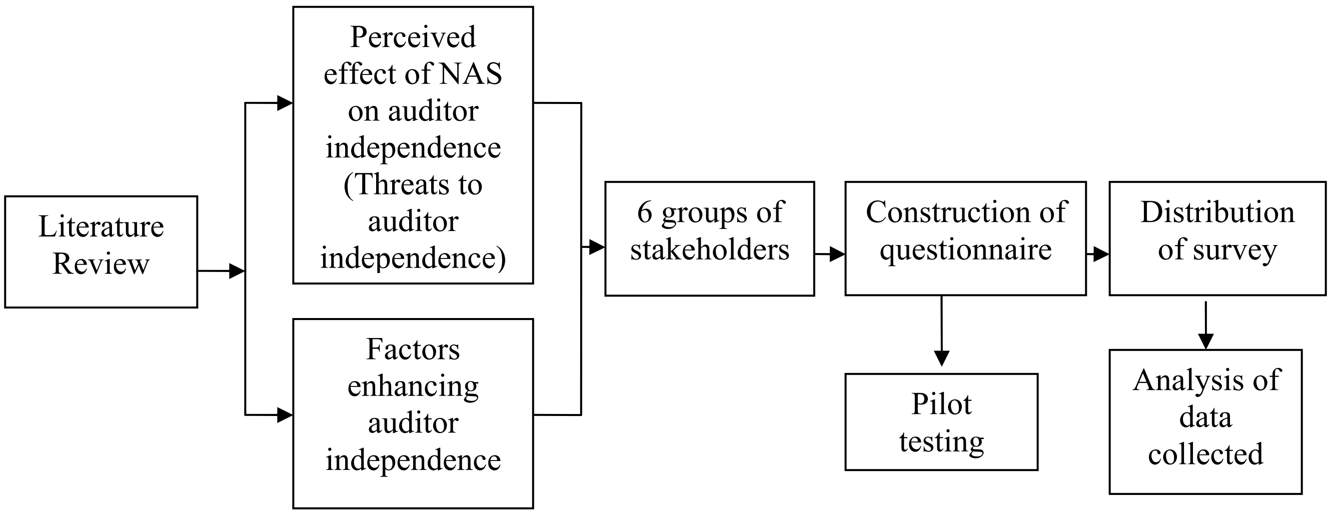

Figure 1.2 *Research Process*

1.5.1 Research Method

Data are obtained using a questionnaire that meets the literature standards, with adaptations for Saudi Arabia. Questions gather information regarding participants' views, opinions, and perceptions on matters relating to auditor independence when NAS are provided. The analysis is quantitative, with survey questions analysed from a Likert scale format. The research methodology relates to data from a different research environment where a lack of disclosure exists.

To achieve the objectives of this study, the questionnaires were sent to all Saudi auditor firms and stakeholders on the Tadawul (Saudi stock market) involved in audited financial statements. Similar to previous studies (e.g., Shockley, 1981; Lin & Chen, 2004), participants included in this study are auditors, users and initiators of financial documentation, and academics. The auditor participants are divided into two sub-groups: international accounting corporations active in Saudi Arabia and other, minor local entities and branches of international entities. The user group is divided into two sub-groups: commercial loan officers and financial analysts. The financial implementors are represented by the financial directors. The academic group consists of representatives from public and private Saudi universities. Financial analysts and commercial loan officers are selected from the ten public banks listed in the Saudi Stock Exchange (Tadawul) and other financial consulting and investment centres operating in Saudi Arabia. Regarding financial directors' category, there were 78 public companies listed in the Tadawul at the time the data were collected and each company received the questionnaire.

1.6 Thesis Order

Chapter 1: Introduction to the Thesis As noted, this is an introduction to the thesis regarding its contribution to knowledge on auditor independence in the context of the Saudi auditing environment. The research aims and questions, conceptual framework, and the research design and method are introduced.

Chapter 2: Context to the Research This chapter concerns the Saudi Arabian environment; understanding the country's political, legal, economical structures contribute to the study findings.

Chapter 3: Review of Auditor Independence This chapter provides a review of the principles of auditor independence, a review of applied and theoretical views in USA, UK, and Australia. The relationship between auditor independence and the NAS, the types of threats that may occur, and the safeguards that can be used are discussed in this chapter.

Chapter 4: Review of NAS Effects on Auditor Independence This chapter discusses empirical studies on the effect of NAS on auditor independence, investigating positive, negative and neutral effects on the phenomena.

Chapter 5: Conceptual Framework This chapter introduces the research theoretical framework used in this study, adapted from the USA Independence Standards Board (ISB).

The ISB developed a conceptual framework for auditor independence identifying five types of threats: self-interest, self-review, advocacy, familiarity, and intimidation. Finally, the four research questions are discussed in detail.

Chapter 6: Research Method This chapter introduces an overview of the research method adopted in this study. It discusses different types of research methods by providing the advantage and disadvantage features of each method. It concludes that, taking into account the Saudi financial environment, the survey method (mail-questionnaire technique) is the most suitable methodology. The study design and planning, including research administration and participants, are presented. The questionnaire structure, format, content, translation, and pilot study are also discussed. The procedures by which the data were collected are also presented. Finally, the reliability and validity of the research are illustrated.

Chapter 7: Data Analysis, Descriptive Statistics This chapter provides the detailed results of the descriptive analyses. The analyses of the demographical data are discussed. Frequency distribution and cross-tabulation analyses regarding the perception effect of the provision of NAS on auditor independence are presented and discussed.

Chapter 8: Data Analysis Inferential Analysis This chapter presents the results of testing eight hypotheses, where the first four hypotheses concern the relationship between auditor independence and the provision of NAS, and the remaining four hypotheses are related to factors to enhance auditor independence. The analyses of stakeholder groups' perceptions of threats and their rankings in terms of affecting auditor independence are discussed in detail.

Chapter 9: Conclusion The final chapter provides a brief summary of the overall study, highlighting its major findings and providing a number of recommendations and limitations, and suggesting future opportunities.

1.7 Summary

This chapter presented the rationale for the thesis and the order of the presentation. As a personal contribution to this research, the author wishes to acknowledge his determination to contribute to the economic future of the Kingdom by expressing his devout wish that this research contributes to the wealth of Saudi Arabia's knowledge. Further, that it fulfils a commitment to the social and economic future of Saudi Arabia, as it is predicated on an efficient and well-regulated financial environment. This research, above all, contributes to the future of trust in the Saudi financial environment.

Chapter 2 Context of the Research

2.1 Introduction

As an emerging economy, the Kingdom of Saudi Arabia continues to pursue business reform and diversification, particularly since its accession to the World Trade Organisation in December 2005 (Niblock, 2006). Government is encouraging private sector growth - especially in power generation, telecommunications, natural gas exploration, and petrochemicals. Foreign investment is the wellspring of this expansion, contributing to the country's infrastructure and bringing with it multinational organisations that introduce their various corporate structures and practices to operate within Saudi Arabia's evolving legislative framework. This private sector growth entails complex relationships with national and international auditing organisations to meet the standards set out by Saudi decree and regulations, which by necessity must comply with the expectations of the sophisticated stakeholders in these global organisations. The majority of these corporations maintain strong relationships with auditing firms to ensure that their financial statements meet global standards and comply with Saudi legislation.

This research aims to investigate and understand a phenomenon of trust in financial matters in the context of its natural setting. Thus, the study of a phenomenon such as stakeholder perception of auditor independence requires not only knowledge of the commercial relationships between users of financial information and external auditors, but also the parties' interactions with their regulatory environment. This allows the researcher to undertake an in-depth investigation to explore the underlying causes and effects of these relationships.

This chapter provides the context of the research by focusing particularly on the Islamic socio-economic structure, the values and mores of Arab society of which auditing is a part, and indeed Saudis and expatriates living in the Kingdom of Saudi Arabia are also the stakeholders whose perceptions are the drivers of this thesis. The chapter is structured to give a broad overview of the nature of the kingdom, how it evolved, its governance through Islam, its wealth, and the financial structures that support its trade and development. The focus then narrows to the country's accounting regulations, with discussion pertaining to auditing and auditors who provide non-auditing services in the Kingdom.

2.2 Saudi Arabia

Global corporations adopt a standardised regulatory environment for trade that allows the free flow of funds around the world. This environment, or accounting framework, is the product of global trade and its regulation, generally adopted from the advanced economies. All countries subscribe to certain conventions that allow such trade. Yet the type of government that administers a nation has an effect on a country's internal regulatory environment. The government reflects the values and norms of its society and provides a relevant regulatory environment for internal trade, which will definitely impact the global practices of the country's guest corporations. Saudi Arabia is an example of this potential disconnects of global pressures and domestic challenges, and the political and religious traditions of Saudi Arabia are determining factors of its ability to manage remarkable change. Therefore, to place this research into context and to assist in the understanding of its challenges, a brief reference to the Saudi environment, demographics and history is included.

2.2.1 Geography

The kingdom, with an area of approximately 2,240,000 sq km, occupies 80 per cent of the Arabian Peninsula. It borders two seas: the Red Sea and the Persian (Arabian) Gulf; and seven countries: Jordan, and Iraq across the Gulf to the north; Kuwait, Qatar, United Arab Emirates to the east bordering the Gulf; whilst Yemen and Oman occupy the southern reaches of the Peninsula. The area of Saudi Arabia is approximate, as the borders with United Arab Emirates and Oman are not precisely defined. Saudi Arabia is divided into thirteen provinces: Makkah, Medina, Riyadh, Eastern Province, Northern Province, Asir, Al-Baha, Hail, Al-Jouf, Jizan, Najran, Tabuk and Al-Qassim.

Saudi Arabia is generally hot and dry, consisting of semi-desert and desert with oases. With an annual precipitation of only 100 mm, almost half the country is uninhabitable. The eastern area is lowland, with plateaux in the west rising to mountains of 3,000 metres in the southwest, an area known for its green and fresh climate. In the summer season, the desert climate is very hot during the day and mild during the night (except for Asir Province in the southwest); the coastal cities are hot, with high humidity. In the winter season, the climate is cold in most areas. The capital, Riyadh, which is to the centre-east, has an average temperature of 42°C in July and 14°C in January. In contrast, Jeddah on the western coast has averages of 31°C in July and 23°C in January.

There are no permanent rivers or lakes in Saudi Arabia. Less than two per cent of the total area is suitable for cultivation, and population distribution varies greatly among the towns of the eastern and western coastal areas, the densely populated interior oases, and the vast, almost empty deserts, such as the Rub'al Khali (The Empty Quarter), the Arabian Desert and East Sahero-Arabian scrublands. The economic value of these provinces is discussed at s2.4.

2.2.2 Demographics

Saudi population figures are approximate, estimated from a high, but now declining birth-rate, and an expatriate population whose numbers reflect the economic climate of the day. Table 2.1 Demographic Indicators presents a comparison of the latest estimates for 2007, compared with those for 1995.

Table 2.1 *Demographic Indicators*

Indicator	Year	
	2007	1995
Population		
Midyear population (in thousands)	27,601	19,967
Expatriates within population	5,576	6,250
Growth rate (percent)	2.1	3.5
Fertility		
Total fertility rate (births per woman)	3.9	4.7
Births (in thousands)	803,190	615,183
Mortality		
Life expectancy at birth (years)	76	73

Source: U.S. Census Bureau, International Data Base

Given the issue of accuracy for the demographics, localisation, that is, the placement of Saudis in jobs previously held by expatriates, shows signs of success with a reduction of expatriate numbers of 11 per cent over the 12-year period (31.3% in 1995, reducing to 20% in 2007). Fertility is falling; however, birth numbers will continue to increase and thus pressure upon the government to provide the social infrastructure required for an inhospitable region.

2.2.3 History of Saudi Arabia

Prior to 1932 and the founding of the Kingdom of Saudi Arabia, the Arabian Peninsula’s populations were under a tribal or clan system, each tribe ruled by a sheikh (Al-Tawail, 1995). The Al Saud family had long attempted to unite the various factions in the area, first in 1745 when Mohammad Ibn Saud, the founder of the first Saudi state, adopted the Wahhabi movement associated with the reformer Mohammad Ibn Abdul Wahhab. The first state was dissolved in 1818 by the Ottoman Empire; however, in 1824 the Saudi heir, Imam Turki Ibn Abdullah, returned to Riyadh after the withdrawal of Ottoman forces and Saudis ruled until 1891 when they were forced by the Al-Rasheed family to flee to Kuwait (Al-Rasheed, 2002). In 1902, following his recovery of the family’s reign from Al-Rasheed, King Abdulaziz bin Abdurrahman Al Saud established a new state. King Abdulaziz Al Saud unified the Arabian Peninsula into a single state, the Kingdom of Saudi Arabia, on 23 September 1932, now celebrated each year as National Day (Al-Tawail, 1995). The King’s immediate issues at the time were consolidation of power and the restoration of law, and under the King’s authority, every sheikh was made responsible for the welfare of his tribe. This system proved successful in facilitating social and economic growth in the region, assisted with the emergence of oil income mid-century (Al-Rasheed, 2002).

King Abdulaziz permitted the Islamic principle of *shura* (consultation) at a reasonable level of expression; however, this was impeded by a lack of expertise in several professional fields. Expatriate Arab skills and knowledge were acquired first, later young Saudis were given scholarships to study abroad. The King appointed a son, Saud, as his successor, and upon his death in 1953, King Saud reigned until removed by another son, Faisal, in 1964. Under King Faisal, assassinated in 1975, and then a third son, Fahd, control of the country was tightened by measures such as removing freedom of expression and nationalising the media. King Fahd suffered a stroke in 1995 and a fourth son of Abdulaziz, Abdullah, became the de facto ruler. King Fahd died in 2005 and Abdullah became the sixth King of modern Saudi Arabia.

2.2.4 Structure of the Kingdom

The Basic Law, adopted in 1992, declared that Saudi Arabia is a monarchy and that the Qur'an is the constitution of the country, which is governed through Islamic law (Shari'a).

The political structure consists of King Abdullah bin Abdulaziz, Head of State and Prime Minister; the Crown Prince, as Deputy Prime Minister, and three advisory institutions, the Royal Cabinet, the Consultative Council and the Council of Ministers. The government's legislation is promulgated through the Council of Ministers and their ministries, regional governments, and municipal councils. The King distributes lesser ministries to influential families and others to maintain political stability. As the ruler by decree must be directly related to King Abdulaziz, Saudi Arabia is therefore an absolute monarchy without parliament or political parties. It is a strict regime and Saudi authority is underpinned by its wealth in oil and its Islamic governance and security response, particularly to threats from Iran and Iraq.

2.3 Government and Legislature

With its singular political structure, an Islamic country and as a sovereign power, Saudi Arabia's legal system impacts its citizens differently to other developed and developing countries. The following constitutes a brief description of governance in Muslim countries and the manner by which legislation is formulated and enacted in Saudi Arabia.

2.3.1 Constitution

The constitution of Saudi Arabian resides in the *Sharī'ah Islam'iah,* or Islamic teachings, from where its traditions and legislation are derived. This is not well known or well understood in non-Muslim countries (Al-Farsy, 1990; Vogel, 1993). The Shari'ah Islam'iah contains the instructions of the manner by which a Muslim society should be organised and governed. It provides the means to resolve disputes among individuals, and by citizens with their governors on day-to-day matters.

The Shari'ah Islam'iah is derived from four sources: the primary source is the Qur'an (the holy book of Muslims). The Qur'an contains the directives of Allah and sets general moral standards for Muslims, guiding their aspirations (Al-Farsy, 1990). The second source, the *Sunnah*, reflects the traditions and utterances of the Prophet Mohammad and explains matters pertaining to the Qur'an. The next source, *Ijma,* records the consensus of religious scholars in their interpretations of the superior books. This source is of particular interest to this study, as it discusses the delegated legislation for a Muslim community. The final source is the *Qiyas*, or arguments by analogy. Judges in Muslim governance may use analogy and reason from the Qur'an and the Sunnah to decide new case law if not previously clearly addressed. This often occurs when interpreting a principle in a new situation (Al-Farsy, 1990; Vogel, 1993; Kamali, 1991).

The Shari’ah Islam’iah is fundamental to Saudi Arabians and touches every aspect of a citizen’s life; political and economic affairs, society, family relationships, morality, the rights and duties of citizens, and religious practices. The following sections describe the formal structures of governance derived from the principles of Shari’ah Islam’iah.

2.3.2 Government

The King, as Prime Minister, is advised by *Majlis Ash Shura* (Consultative Council), established in 1992. In August 1993, aiming for efficiency, King Fahd restructured the Majlis Al-Shura. Initially composed of 60 prominent members of Saudi social, political, and religious life, the Council expanded to 90 members by 1997. The Majlis Al-Shura advises the King and the Council of Ministers on a regular basis on matters pertaining to government programs and policies. The Shura Council’s primary function is to assess, interpret, and modify the Kingdom’s system of laws, by-laws, contracts, and international agreements. A 2003 decree allows the Council to initiate legislation; further, it can now respond to argument, with the King as final arbiter. In October 2003, the Saudi press reported elections to be held for one third of the Majlis Al-Shura members within three years, and this matter was raised again when the number of members increased in April 2005 to 150, although there has been no further comment from the government.

The Council of Ministers, appointed by the King initially in 1953, advises on the formulation of general policy and directs the activities of the large and growing bureaucracy. The council consists of the King as prime minister, the deputy prime minister and twenty ministers. Legislation is by resolution of the Council of Ministers, ratified by the Consultative Council and royal decree, and must be compatible with the Shari’ah Islam’iah.

The kingdom is divided into 14 provinces through which local affairs are administered. Each is headed by an Emir (governor) appointed by the King. The governor is assisted by a vice-governor and a provincial council, composed of the heads of the province’s government departments and a ten-member council of prominent individuals in the community who are appointed to four-year, renewable terms. In 1993, late King Fahd promulgated new by-laws for the Provincial System to aid in the administration of the country’s provinces and to facilitate their continued development.

2.3.3 Judiciary

Saudi Arabia's legal system, as noted at s2.3.1, rises from Shari'ah Islam'iah, which is the basis for its legislation and legal decisions, supplemented by government legislation. The Justice Ministry administers to the judiciary and maintains the courts (Long, 1997). The King is responsible for the implementation of judicial rulings and acts as the final court of appeal and as a source of pardon, thus the judiciary is subject to the influence of the royal family.

The judiciary was established in its present form in 1975, based on the Shari'ah courts. The Law of the Judiciary, Article 5, specifies that the Shari'ah courts consist of four levels; the Supreme Judicial Council which manages judicial appointments, the work of the courts, and it can intervene on judgements (Ministry of Justice, 1975). Next is the Appellate Court, which includes the Penal Suite, the Personal Status Suite and it acts as court of appeal for other cases.[3] Third is the General Court,[4] where one or more judges can pass judgement on all cases except those concerning the Summary Courts (Al-Tawail, 1995). Last are the Courts of Summary Jurisdiction with a similar structure to the General Court, for misdemeanours, disciplining and some other cases.[5]

Adopting the Shari'ah Islam'iah as the principle of the Kingdom's Constitution means that all activities of individuals and government must be ruled by such law and no other law can oppose it. However, when Saudi Arabia became a recognised state, King Abdulaziz issued decrees (*nizam,* plural *anzimah*) to address modern legal issues for the state, such as laws for weapons, nationality, social insurance, motor vehicles; as it was not possible to wait for the *ulama* (religious scholars) to develop new regulations. This, in turn, reduced the judicial dependence on the ulama and limited their authority. As a result, the ulama refused to enforce royal decrees (Vogel, 1993). The controversy between the opinions of ulama and the government led to two legal streams: one based on the shari'ah islam'iah and the other considering secularised decrees. Special courts were created for secularised regulations, therefore the country has a dual legal system, for example, the secular Grievances Board investigates complaints of improper behaviour by government officials. Vogel (1993, p.175) describes the consequence of this dual legal system:

> When confronted with a case arising under nizam, the shari'ah court judge will do as he himself thinks right. If he thinks that the case is governed by figh[6], he proceeds to

[3] Article 10 of the Law of the Judiciary, 1975, Ministry of Justice.
[4] Article 22 of the Law of the Judiciary, 1975, Ministry of Justice.
[5] Article 24 of the Law of the Judiciary, 1975, Ministry of Justice.
[6] Shari'ah Islam'iah law.

> decide it according to the figh without reference to the nizam. If instead he thinks it a proper exercise of siyasa law-making[7], he usually dismisses the case, leaving it for some administrative entity to enforce.

Although Saudi Arabia's legislation stems from the Shari'ah Islam'iah, its religion-based legal practices are slow and methodical, and the two judicial systems result in ineffectual legal decision-making. Shari'ah judges can differ in their interpretation of the primary law, and there is little coordination between the religious and secular judiciary (Al-Saleh, 1994). The Shari'ah judges refuse to apply secularised rules as they consider all matters can be resolved through the primary sources; also that the secularised legislation is contrary to the Constitution.

Issues regarding the dual legal system in Saudi Arabia impact auditors in their duties, especially when they have to deal with issues under opposing legal decisions, the Shari'ah Islam'iah and the certified public accountants' regulations. Moreover, in the case of a dispute, one party might favour the Shari'ah law and the other, secularised regulations, thus resolution is generally made outside the court systems.

2.3.4 Summary

The constitution of Saudi Arabia is based on the Shari'ah Islam'iah, which is, in turn, derived from four sources, namely, the Qur'an, the Sunnah, the Ijma, and the Qiyas. The Shari'ah Islam'iah provides the means to resolve disputes among individuals on day-to-day matters. However, the modern issues such as nationality and social insurance are addressed by decrees issued by the government. The dual legal system in Saudi Arabia may impact modern issues such as accounting and auditing issues where auditors may have to deal with both opposing systems.

2.4 Economic Development

The area now occupied by the Kingdom of Saudi Arabia was originally severely limited in its resources. The Eastern province survived on subsistence agriculture, growing dates, few crops, and fishing. The Arabian desert was a hostile environment where permanent habitations existed only at oases through nomadic animal husbandry and subsistence farming. The Western province, the Hijaz, was more urban, with long-distance trade and services to pilgrims to the Holy Cities of Mecca and Madinah (Long, 1997). Distance, poverty and tribal

[7] Secularised non-religious law.

societies made the creation of a merged community difficult, until King Abdulaziz used the annual Muslim pilgrimage revenue, customs duties and *zakat*[8] to stabilise the country and gain loyalty from the tribal leaders (Stoff, 1980).

2.4.1 Oil-based Economy

In 1933, the Arabian American Oil company (ARAMCO) was established by four American oil companies: Standard Oil of California (30%); Texaco (30%); Esso (30%); and Mobil Oil (10%). Six years after the country was established, oil was discovered in 1938 and the new revenue source confirmed the King's authority, and gave the new Saudi government influence and leverage in international relations. The kingdom thereupon moved from a subsistence economy to one of high expenditure fuelled by the oil incomes. As an example, annual government revenue grew from $US15 million in 1946 to $US100 million in 1950; and then to $US338 million by 1960 (Niblock, 2006). With the new financial resources, Saudi Arabia began its transformation to a modern state with the establishment of the Council of Ministers in 1953, and this governance structure continued under successive rulers as oil revenues rose (Niblock, 1981). In 1972, the Saudi government obtained a 25 per cent equity share of the oil producer, Aramco, and in 1980, the company became 100 per cent Saudi-owned (Moliver & Abbondante, 1980). Despite industry diversification, oil continues to be the main income producer for the country, contributing up to 90 per cent of total revenues during the last half-century. (Choudhury & Al-Sahlawi, 2000; Niblock, 2006). The Saudi Minister of Petroleum and Mineral Resources reported to the 6th International Oil Summit Conference in Paris in April 2005 that the proven Saudi oil reserves were 25 percent of the world's proven oil reserves, 261 billion barrels, plus probable further reserves of some 100 billion barrels. Thus the Saudi economy will continue its dependence on oil revenue for the next fifty years, given that the country is also embarking on industry diversification.

2.4.2 Five Year Plans

Preservation of the government and the provision of national security are the drivers for Saudi Arabia's political future (Al-Farsy, 1990). For several decades, these two goals remained, and continue as the cornerstones of the Saudi government's succeeding five-year strategic plans. The development plans focus on differing aspects of Saudi socio-economic life and include balanced urban, material, and social development as well as improved standards of living and quality of life for its citizens. Excerpts from the plans (Saudi Ministry

[8] Religious tax

of Economic and Planning) are presented below; Table 2.2 Focus of Succeeding Development Plans.

After 12 years of negotiation, Saudi Arabia won entry to the World Trade Organisation (WTO) in 2005, becoming the 149th member. This signals considerable progress in liberalising the economy as Saudi Arabia opens its long-protected economy to the outside world (Niblock, 2006).

Table 2.2
Focus of Succeeding Development Plans

Development Plan/s	Focus
First, second, and third 1970-1984	Infrastructure projects and basic government services, water supply, electricity, education; next oil infrastructure, transport and housing. The third included establishment of a comprehensive public administration
Fourth and fifth 1985-1994	Increasing public services, industry diversification, promoting private sector input to counteract declining oil revenues. The fifth plan followed these themes, but the 1991 Gulf War slowed implementation
Sixth and seventh 1995 - 2004	Higher education, internal privatisation of health and other public services, efficiency of services for both sectors. The seventh continued these themes, renewing diversification and adding localisation[9]
Eighth 2005 - 2009	As the economy matures, the strategic plan format extends to 20 years and is presented in four parts. The vision focuses on Saudi citizens' quality of life and standard of living by providing quality education and health care, liberalising trade and creating relevant jobs for the Saudi workforce. The eighth plan allocates targets under the vision

2.4.3 Summary

The government of Saudi Arabia's development plans have substantially changed the nation, improving the living standards and quality of life for its citizens. However, as the largest oil exporter, Saudi Arabia's economy is sustained by the recent oil price increase, which now accounts for some 80 per cent of total revenue. The issue is thus that industry diversification may slow, increasing the country's vulnerability in the event of oil prices returning to historical trends. The economic development plans have attracted local and foreign investors and provided more opportunities for citizens and non-citizens in the field of accounting and auditing. Thus, there is a need to improve the accounting and auditing

[9] Replacement of skilled expatriates with skilled Saudis

profession, in particular, the accounting and auditing standards to meet the special circumstances of the country.

2.5 Financial Structures

Saudi government's focus on diversifying economic reliance from oil revenues offers opportunities to the private sector, as funds may be obtained from both sectors. As an example, effective financial structures and practitioners are required to administer government affairs and to manage public-private partnerships for infrastructure projects. Further, financial markets demand relevant and reliable financial information to facilitate effective decision-making. The institutions that form Saudi Arabia's regulatory financial framework; the financial structures and the origin and evolution of the larger members of the finance industry are discussed in the following sub-sections.

2.5.1 Saudi Arabian Monetary Agency

Established in 1952, the Saudi Arabian Monetary Agency (SAMA) is the central bank of Saudi Arabia. It performs a crucial role in the country's monetary system: issuing currency, maintaining stable prices and managing the exchange rate and foreign reserves. It also administers the government's finances and partially regulates the finance sector. Under Shari'ah Islam'iah law, SAMA is prohibited from paying or receiving interest; however, management fees are permitted.

Initially, SAMA developed a monetary system to replace many foreign currencies in usage and established the Saudi riyal, based on the silver tokens that were in use until mid-century, and maintaining an exchange rate based on the US dollar. The central bank also issued gold coins and Pilgrim Receipts (Hajj Receipts) to relieve pilgrims from the burden of metallic currency in use at the time. These Pilgrim Receipts later became accepted throughout the Kingdom as de facto currency, foreshadowing the first Saudi banknotes in 1961, which then replaced the Pilgrim Receipts (Long, 1997; Al-Suhaimi, 2001).

Prior to 1952, foreign banks and local exchange dealers administered the monetary needs of the Kingdom. SAMA's regulatory function, through the 1966 Banking Control Law, facilitated the development of a national banking system. The law designated capital reserves, liquidity, and loan conditions. Restrictions on foreign banks limited their growth by defining the number of branches and capital wealth each could attain. However, by the mid-1970s all foreign banks were converted to public companies under joint-venture conditions where non-

Saudis could invest but with a mandatory majority of Saudi shareholders. (Presley & Wilson, 1991; Johany, Berne & Mixon, 1986).

Auditing protocols are set out in the 1966 Bank Control Law (Article 14), administered by SAMA and discussed throughout s2.7. However, for financial institutions, the law requires financial institutions to select two external, licensed auditors to report annually regarding companies' financial positions. To assist in meeting their regulatory obligations, the majority of Saudi financial institutions have audit committees reporting to their boards. SAMA issued *Rules and guidelines for banks for organising audit committees*, (SAMA, 1996) to explain an audit committee's responsibilities and functions, and also the relationship between the audit committee and other internal organisational divisions: internal control systems, external auditors, and the bank regulators. Further, Rule No.7(a) notes a role for the audit committee to monitor the relationship between the external auditor and the management of the bank. Moreover, in regard to ensuring the independence of the external auditor, Rule No. 7b states:

> The Audit Committee should ensure that the external auditors work independently and objectively by holding regular meetings for discussing various important issues and also by getting representation in the form of a letter from the external auditors on an annual basis wherein they confirm their independence in accordance with regulatory and professional regulation. In order to further strengthen the concept of independence and objectivity of external auditors, the Audit Committee should require that the engagement partners of the external firm are rotated every three years (SAMA, 1996).

2.5.2 Finance Industry

Despite its short history, the finance industry in the kingdom has developed to meet the economic needs of the country and to operate within an international and volatile financial environment. The first commercial bank in Saudi Arabia, the Netherlands Trading Society (today, the Saudi Hollandi Bank), was established in 1927 as a trading office in the port city of Jeddah (Ramady, 2005). Due to increased public sector activity during the 1950s, the demand for financial services opened opportunities for local and foreign institutions to set up offices and banks in the country. Further, the Muslim practice against accepting or demanding interest enhanced this attractiveness.

The National Commercial Bank was the first domestic bank established in 1953, followed by Riyad Bank (1957) and Bank Al-Watany (1958). However, mismanagement forced SAMA to close Bank Al-Watany and merge it with Riyad Bank in 1961 (Al-Suhaimi, 2001). To raise confidence in the financial markets, the government acquired 38 per cent of the merged Riyad Bank and implemented the *Banking Control Law 1966* (Ramady, 2005).

After the creation of SAMA in 1952, as noted in s2.5.1, international institutions were attracted to the country, including Banque du Caire, Banque du Liban and First National City Bank of New York. With insufficient government controls over funds flows at the time, this resulted in the transfer of the greater proportion of banking profits from the country.

The 1970s were a period of significant growth in financial activity occasioned by major infrastructure projects, with many organisations entering the Saudi market. Table 2.3 Saudi Financial Institutions shows the status of current financiers (2007).

Table 2.3 shows that, where six of these Saudi institutions are joint-venture banks; four have some government ownership, while one is wholly owned by the private sector. The other ten GCC and international institutions have banking licences; however, only five are pursuing business. The aim of the licences is to increase competition in the banking sector through the creation of a wider and deeper market.

Table 2.3 *Saudi Financial Institutions*

	Financial Institution	Status	Established
Saudi	Saudi Hollandi Bank	Joint-venture, Saudi and non-Saudi ownership	1927
	The National Commercial Bank	Saudi private sector and government ownership	1951
	Riyad Bank	Saudi private sector and government ownership	1957
	Bank Aljazira	Joint-venture, Saudi and non-Saudi ownership	1975
	Saudi British Bank	Joint-venture, Saudi and non-Saudi ownership	1978
	Banque Saudi Fransi	Joint-venture, Saudi and non-Saudi ownership	1977
	The Saudi Investment Bank	Joint-venture, Saudi and non-Saudi ownership	1976
	SAMBA	Saudi private sector and government ownership	1980
	Al Rajhi Bank	Wholly owned by Saudi private sector	1988
	Arab National Bank	Joint-venture, Saudi and non-Saudi ownership	1979
	Bank Albilad	Saudi private sector and government ownership	2004
GCC	Gulf International Bank (Bahrain)		1999
	Emirates Bank (UAE)		2004
	National Bank of Bahrain (Bahrain)	Licensed but not operational	
	National Bank of Kuwait (Kuwait)		2006
	Muscat Bank (Oman)	Licensed but not operational	
International	Deutsche Bank (Germany)		2006
	BNP Paribas (France)		2005
	J.P. Morgan Chase N.A (USA)	Licensed but not operational	
	National Bank of Pakistan (Pakistan)	Licensed but not operational	
	State Bank of India (India)	Licensed but not operational	

Source: Saudi Arabian Monetary Agency (2006)

2.5.3 Credit Organisations

Specialised Credit Institutions play an important role in the Saudi economy. Unlike commercial banks, which favour short-term lending; special credit institutions provide long-term and interest-free lending to industry, agriculture, and real estate to diversify the Saudi economy. Thus, these institutions are not in direct competition with the commercial banks. Generally, these financial institutions opened in the early 1970s and they are funded almost exclusively by the Saudi government. These institutions are: Saudi Arabian Agricultural Bank (SAAB), Saudi Industrial Development Fund (SIDF), Real Estate Development Fund (REDF), Public Investment Fund (PIF), and Saudi Credit Bank (SCB). A major concern regarding these institutions is the potential for default, especially for agriculture (SAAB) and real estate (REDF). These two institutions lend to private citizens who suffer adverse economic and environmental conditions and foreclose. SIDF lends to larger business entities and generally avoids this issue.

2.5.4 Equity Market

The first public company in Saudi Arabia, the Arab Car Company, was founded in the mid-1930s, and by 1975 there were 14 joint stock companies, that is, companies' majority owned by the government, and the remainder of the stock available to Saudi individuals (Azzam, 1997). The rapid infrastructure growth and changes to bank ownership (s2.5.2) in the 1970s and early 1980s led to the establishment of a large number of public companies, thus an unprecedented growth in tradeable shares for Saudi citizens.

However, the stock market was inefficient as it lacked an effective mechanism to protect investors and thus had a high level of risk for trading. Researchers Abdeen and Shook (1984) and later, Al-Dukheil (1995) found an absence of a clear and organised legal framework for a stock market, with ambiguous regulations affecting companies and share trading issued by three government sources. The Ministry of Commerce was responsible for the formation of new companies; the Ministry of Finance set the overall policy of the stock market; whilst SAMA administered the stock market, including authorising brokers (Azzam, 1997). Nevertheless, a stock exchange trading system was developed by SAMA in line with current technology during the decade and by 2001, a fully electronic system, Tadawul, was introduced.

Whilst the means to trade existed, there were functional issues impacting the market:

- there was a lack of professionalism in the industry, with non-specialist small offices acting as brokers under a trade commission licence. In these general accounting offices, inexpertise in share trading strategies compounded risk for the firms' clients
- large shareholdings by directors and executives of a firm deterred small investors from acquiring shares on the market, due to lack of accountability and the risk of financial manipulation
- Saudi citizens were not knowledgeable regarding financial matters, and knew little about stock trading to diversify their investments and reduce risk. As a corollary to the last point, a lack of financial information, or even the recognition of its importance in investment decision-making, led investors to invest in real estate and valuable metals.

To attract small investors and to develop an efficient market, a clear authority for market regulation was necessary. In July 2003, the Capital Market Authority (CMA) was established by the Capital Market Law[10], removing administration from SAMA. The objectives of the CMA are to create an appropriate investment environment through the regulation and development of the Saudi Stock Exchange. However, whilst there is now a formal trading environment, there remains a need to improve its efficiency in terms of financial reporting and transparency.

Although the Saudi stock market is categorised as an emerging market due to its age and relative size, it is ranked first in the developing countries based on market capitalisation in 2005. Table 2.4 Emerging Markets shows these rankings.

Table 2.4 *Emerging Markets*

Rank	Country	Market Capitalisation	Price to Earnings Ratio	
		USD million	2004	2005*
1	Saudi Arabia	649,117	24	35
2	Korea	543,950	13	11
3	Russia	458,229	15	18
4	Brazil	446,208	12	10
5	India	393,985	15	17
6	Taiwan	346,984	12	14
7	South Africa	285,105	14	14
8	Mexico	235,973	15	13
9	China	161,912	12	14
10	Malaysia	141,167	15	11

*Estimated

Source: Bakheet Financial Advisors and DataStream (2005).

[10] Royal Decree M30, June 2003.

Over the last decade, the Saudi stock market activity increased from 60 member companies in 1992 to 111 in 2007. Table 2.5 Performance of the Saudi Stock Exchange from 1998 to 2007 shows the number and volume of transactions and market value of the exchange over the decade.

Until 2006, only Saudi nationals and GCC nationals were permitted to hold and trade shares in Saudi companies. Formal financial investments for other Saudi residents were confined to products offered by Saudi banks. In February 2006, the Saudi index reached its highest value (20,635 points) to that date, but dropped in the following two trading sessions to 18,740 points, or some 10 per cent of the market value.

Table 2.5

Performance of the Saudi Stock Exchange, Decade to 2007

Year	Tadawul All Share Index	Tadawul Growth per year	Market Value SA Riyal in Billions	Number of Shares Traded in Millions	Number of transactions in Thousands
1998	1,413	-28%	160	295	377
1999	2,029	44%	229	528	438
2000	2,258	11%	254	555	498
2001	2,430	8%	275	692	605
2002	2,518	4%	281	11,430	1,034
2003	4,438	76%	590	35,414	3,763
2004	8,206	85%	1,149	63,675	13,320
2005	16,713	104%	2,438	70,996	46,608
2006	7,933	-53%	1226	73,439	96,096
2007	11,176	41%	1946	58,862	65,665

Source: Tadawul 2007

The decline continued over the next two months, and the value of the day trading in the Saudi market decreased from SR47 billion to SR5 billion. Reasons for the decline were described variously by analysts as the market being overextended, with a price/earnings ratio over 45 for some companies; lack of confidence in the market; or rumour mongering. In March 2006, to increase the depth and liquidity of the market, all Saudis, nationals and residents, were invited to own shares and trade in Saudi companies.

2.5.5 Summary

The previous section (s2.5) provides a brief historical review of the financial system applied in Saudi Arabia. Prior to 1952, foreign banks and some local money exchange dealers administered the monetary needs; however, in 1952, SAMA was established and took the role of the central bank of the country. SAMA issued the *Bank Control Law* in 1966, which assigned how commercial banks operate in terms of the required capital reserves, liquidity, and loan conditions. The law also requires banks to select two external auditors to audit their financial statements. As of 2007, ten local banks, five GCC banks and five international banks operate in the country.

The governmental credit institutions play a major role in providing long-term and interest-free lending to industry, agriculture, and real estate. The equity market is still in its early stages. It suffered from the absence of a clear and organised legal framework for a stock market. However, after the establishment of CMA, a new formal trading environment was introduced to attract small and foreign investors.

2.6 Accounting and Auditing Protocols

The Saudi audit protocols evolved from early accounting methods used by international corporations in Saudi Arabia. These subsidiary organisations reported local financial data to comply with the formats and protocols of their head offices' countries of origin. Further, Saudi decrees and regulations followed shari'ah law and thus differ in their reporting requirements (example: interest-based data, zakat, and statistics). Saudi accounting regulations date back to the 1930s Commercial Business Regulation (Al-Qahtani, 2006). By mid-century, although auditing was mandatory for financial institutions (s2.5.1), an organisation's auditing reports were viewed as internal documents and auditors' reports on a company's financial statements were published only when deemed necessary by the executive.

The development of accounting and auditing protocols in the kingdom forms the antecedents of the theme for this study, the effect of non-audit services on auditor independence. The laws, act and order that govern accounting and auditing are discussed in the following sections, followed by a discussion of the development of accounting and auditing in Saudi Arabia.

2.6.1 Income Tax and Zakat Law

The *Income Tax and Zakat Law 1950* was critical to the advancement of the accounting and auditing profession in Saudi Arabia; Article 16 stipulated an internationally recognised auditor should prepare a company's taxation report. At that time, companies were generally managed by their owners and audits were not a priority for zakat and income tax purposes, with few accounting firms and offices in the kingdom. The first accounting firm appeared in 1955 , the non-Saudi firm of Saba, Nawar and Co. and the first Saudi accounting firm was Daghastani and Abdul Wahab, 1959.

2.6.2 The Companies Act

The *Companies Act 1965*, amended in 1985 and in effect today regulates, inter alia, appointment of an external auditor, the relationship between the auditor and management, and the responsibilities of the auditor. Articles 123 to 128 of the *Companies Act* relate to the financial disclosure requirements of joint stock companies, expatriate and Saudi ownership, and Articles 129 to 133 describe the manner of auditor appointment and conditions of the relationship between the two parties. Article 169 includes limited liability partnerships in entities for audit regulations. The following paragraphs elaborate these points.

The company's mandatory financial statements each year described in Article 123 are balance sheet, profit and loss statement, and stock inventory. The directors report on the company's activities and financial position, including distribution of net profits, and this information is available to the external auditor fifty-five days before the annual general meeting (AGM) for examination and report on the financial statements. Articles 124 to 129 relate to financial information disclosure, including shareholders' rights to financial information as defined by the Act. Article 130 states that one or more licensed external auditors are to be appointed at the AGM for the following year, stating the terms of the appointment in duration and fee structures. It also identifies situations where auditor independence may be impaired, discussed at s2.8.1.

These regulations, especially Article 130, describe protocols and practices fundamental to auditors' responsibilities, and which impact their independence. However, there is insufficient detail in the *Company Act* to describe comprehensively all situations where auditor independence is at risk; the impact of NAS on auditor independence that is the focus of this study is not clarified. There is some debate whether the provision of NAS to an audit client is indeed forbidden in Saudi Arabia (Shinawi & Crum, 1971). Without clear guidance from legislation and decrees, the nature of auditor independence in Saudi Arabia can be misinterpreted.

2.6.3 Bank Control Law

SAMA, as the central bank (s2.5.1), introduced the *Bank Control Law* in 1966. Over time, SAMA issued accounting standards, explanatory notes, and guidelines regulating financial institutions' audit committees. Relevant to this study, Article 14 of the *Bank Control Law* requires all financial institutions to appoint two licensed external auditors (note s2.6.2), although the law does not specify the selection and appointment criteria, or criteria related to auditor independence. Later, SAMA issued an explanatory note on the selection process, stating that a financial institution's audit committee should determine the specifications for the audit, then select five licensed chartered accountants to tender for the audit. In their proposals, the bidders should include the formal qualifications and banking experience of the audit team members; the audit firms' industry quality ratings (for international standards); identify potential conflicts of interest including any business relationships between the audit firm or its members and the client organisation personnel (SAMA, 1996). This guidance implies the necessity for auditor independence; however, the note does not identify areas of risk to independence or how such risks may be addressed.

In its role of regulator, maintaining standards in the country's financial markets, SAMA also notes its interest in the appointment of external auditors (SAMA, 1996) that:

> It is essential that the views of SAMA, and in the case of foreign subsidiaries of other appropriate regulatory authorities, be obtained prior to selection, appointment and termination of external auditors.

2.6.4 Accounting Law

The Ministry of Commerce and Industry, the auditor licensing authority, issued Order No.422 of 1968 which sets out the criteria, including qualifications, for auditor registration. However, in response to the oil-funded trade and economic developments in the 1970s, the first accounting law was issued in 1974 by the Royal Decree No. M/43. The Law established *the Supreme Committee for Professional Accountants* to supervise and oversee accountants and auditors. The committee was charged with licensing certified accountants and imposed standards such as age, nationality, education and experience in accounting and business. Although these factors were useful in licensing, they proved insufficient to accord standing to the profession. Following the formation of the Saudi Organisation for Certified Public Accountants, the Law was replaced in 1992 by Royal Decree No. M/12, the *Statutory Accountants Act* (s2.8.3).

2.6.5 Summary

This section provides a historical overview of the regulations that affect accounting and auditing in Saudi Arabia. These regulations were issued by different governmental departments and ministries to meet their specific requirements that are related to accounting and auditing. These regulations are: *The Income Tax and Zakat Act 1950*, issued by the Department of Zakat and Income Tax; the *Companies Act 1965*, issued by the Ministry of Commerce and Industry; the *Bank Control Law 1966*, issued by the Saudi Arabian Monetary Agency; and the *Statutory Accountants Act 1992*, issued by the Ministry of Commerce and Industry.

2.7 Accounting and Auditing Standards

The first Saudi accounting firms were established in 1955, and by 1970 there were over 50 such firms in the kingdom (s2.5.1). Despite the increase in business and the growing number of audit firms, regulatory protocols discussed in the preceding sub-sections proved insufficient to the formation of accounting and auditing principles, standards, or a code of ethics. These matters are discussed in the following sub-sections.

2.7.1 Regulating Accountants and Auditors

The Ministry of Commerce assists SAA, the Supreme Committee for Professional Accountants and others through funding their initiatives. In 1980, in consultation with a major Saudi accounting firm owner, Abdulaziz Al-Rashid, a review of accounting principles and practices was proposed to meet the rapid economic development across the country and to be relevant to the socio-economic and religious environment of the Kingdom. Al-Rashid's office, with the assistance of King Saudi University, prepared a paper on the issues faced by the industry for the Ministry of Commerce, which, in turn, funded a project, inter alia, to investigate accounting and auditing standards, and establish internal systems for the profession (Al-Angari, 1999). This proposal, conducted over a decade, consisted of three parts:

1. Comparative study of the profession in selected countries (1980-1981).
2. Preparation of conceptual framework for the profession (1982-1986).
3. Establishment of the Saudi Organisation for Certified Public Accountants (1992).

The first phase was a comparative study of accounting in three countries, based on the economic environment and the level of development of the industry. USA, West Germany (before reunification) and Tunisia were chosen, and the themes selected for analysis were each country's accounting standards and financial reporting, auditing standards and reporting, professional ethics, and internal organisation of the accounting profession. Al-Rashid's office submitted this report to the Ministry of Commerce in 1981.

The second phase, 1981 to 1986, concerned alternative approaches to improve professionalism in accounting and auditing in Saudi Arabia; the first approach developed recommendations to raise the standard of the industry across the country, the second focused on urgent accounting and auditing issues. The second approach was adopted, comprising the objectives, concepts and presentation necessary for financial accounting and disclosure requirements; and the development of accounting and auditing standards.

Three teams of international and local academics and industry members were selected. The first team developed protocols to standardise all aspects of professional conduct: licensing, training, monitoring and other management issues. The second team was concerned with the development of the auditing standards and all issues related to auditing procedures and reporting. The third team considered financial accounting, a conceptual framework of financial accounting for Saudi Arabia, and developing accounting standards. By the end of 1985, a five-volume draft report was submitted to the Ministry; four volumes on professional standards, while the fifth concerned an organisation to oversee the profession in Saudi Arabia and set a code of professional ethics. Recommendations of professional standards were accepted by the Ministry of Commerce and became effective in November 1985 as Order No.692, which recommended the standards, but they were not made mandatory until Order No.852 of 1990. (Al-Angari, 1999)

The recommendations of the fifth report, regarding a code of ethics similar to international accounting practice and a self-regulatory organisation for the profession, were not accepted by the Ministry, thus the government remains in full control of accounting and auditing in the kingdom. The *Company Act* has ethical aspects, such as prohibiting audit firms and offices from advertising their services, or disclosing client information without prior permission; however, this was not deemed an adequate code of ethical conduct.

Whilst the Accounting Law's Supreme Committee for Professional Accountants aimed to standardise accountants' licences rather than regulate the industry, the law failed to address important issues, such as inadequate accounting and auditing quality to meet the country's needs, and insufficient emphasis on the qualification standards for accountants. Saudi's financial industry requires a self-governing organisation to standardise, administer and lobby for change for the profession. Further, there was a growing international debate regarding government control of the profession; that self-regulation was preferable, as it was direct and more responsive to changing circumstances. This was recognised to a degree in the *Accounting Law*, but was insufficient to be viewed as self-regulation. (Al-Angari, 1999).

Phase three of the accounting project, the *Certified Public Accountants Law* of 1991, established the Saudi Organisation for Certified Public Accountants (SOCPA), which reports to the Ministry of Commerce and is chaired by the Minister of Commerce. The objectives of SOCPA are:

- reviewing, developing and adopting accounting and auditing standards
- developing the examination standards for certified public accountants
- organising and supervising continuing training
- conducting research in accounting, auditing and related fields
- monitoring adherence to accounting and auditing standards
- publishing relevant accounting and auditing material
- participating in accounting seminars and conferences locally and internationally.

At the time of writing, 17 accounting standards, five related opinions and interpretations; and 14 auditing standards and 14 related opinions were on issue by SOCPA.

2.7.2 Professional Development

Since the early 1980s, the accounting department of King Saud University performed a role in the professional development of the country's accountants, organising symposia on major accounting and auditing-related issues raised by participants from many academic institutions, private and public sector organisations and major audit firms. Moreover, the University established an academic organisation, the Saudi Accounting Association (SAA), which publishes the peer-reviewed *Accounting Research Journal*. The SAA continues to support the Saudi accounting profession by publishing academic material and providing ongoing training opportunities for lifelong learning for its graduates and others.

2.7.3 Summary

This section shows how the accounting and auditing principles, standards and the code of ethics in Saudi Arabia were developed. The development went through three phases. The first phase in 1980 was a comparative study of accounting and auditing in three different countries. The second phase in 1982 focused on improving professionalism in accounting and auditing in the country; and the last, in 1992, established SOCPA and the Statutory Accountants Act. The role played by the department of accounting at King Saudi University and the Saudi Accounting Association (SAA) was influential in the development of the accounting and auditing profession.

2.8 Auditor Independence

Regulations for auditor independence stem from the 1965 *Company Act*, 1985 Auditing Standards, SOCPA regulations and the 2004 *Income Tax and Zakat Law*, the Professional Code of Ethical Conduct, and the standard of an auditor's objectivity, impartiality and independence. The following sections discuss these matters.

2.8.1 Auditor's Responsibilities

The *Company Act* of 1965, although identifying eight legal forms of entities that must comply with its regulations, specifies only two forms of companies for which financial statements must be audited by a certified accountant (Articles 130 and 169): joint stock companies and the limited liability partnerships. The Act also states that auditors work independently from their clients; Article 130 declares that auditors are prohibited from auditing their own companies, thus auditors must not have equity or financial interests in their clients. Auditors are also forbidden to be members of the board or to perform technical or administrative work for their clients, including any advisory capacity. With regard to the relationship between the auditor and the board, the Act states that the auditor of the company must not be a relative to the fourth degree of any of the founders or directors of a client. Article 131 explains the audit work, and an auditor's right to have access to the client company's books, records and all other documents for an informed opinion on its financial statements. If the auditor faces any difficulties from management in accessing all information necessary to complete the audit, this matter should be reported to the board. Although the *Company Act* notes these situations where auditor independence may be at risk, the context is without guidance or a conceptual framework to regulate auditor independence.

2.8.2 Auditing in Saudi Arabia

The *Income Tax and Zakat* (alms) Law was first issued in 1950, establishing the Department of Zakat and Income Tax (DZIT). The separate components of zakat and tax were recognised in March 2004 by Royal Decree No.M/1.The Zakat Law specifies the collection of zakat from Saudi citizens and all GCC individuals living in the country. In accordance with Shari'ah Law, Saudi companies pay zakat at a rate of 2.5 per cent on the net working capital after all gains and losses. The Tax Law requires all others working in the Kingdom to pay income tax (Article 60-b). For joint ownership companies with non-Saudi citizens, Saudi and GCC owners are accountable for zakat for their share of the firm's profits; whilst for their part, non-GCC citizens pay income tax. Further, the Tax Law specifies the minimum bookkeeping records for both laws; Article 60-e also mandates that the tax assessment be approved by a certified public accountant when taxable income exceeds one million Saudi Riyals.

The current auditor of the company was prohibited from providing tax and zakat services to their audit clients until 1998, when SOCPA issued *Rules permitting the provision of tax and zakat services* which removed the prohibition on NAS (Hudaib, 2003). This impacts independence, as auditors may act as advocates, defending their clients' position against the DZIT. Conversely, NAS services may enhance auditor independence. It is argued that auditors add more reputational capital when their revenues increase by the provision of NAS. Thus, to maintain their reputational capital, auditors are able to resist management pressure (DeAngelo, 1981b). Moreover, providing tax and zakat service to the audit client will make the auditor unique to that client. As a result, auditors can maintain their independence due to their uniqueness and their great desire to maintain their reputational capital (Goldman & Barlev, 1974).

2.8.3 The Statutory Accountants Act (SAA)

According to Article 13 of the SAA (1992), *A certified public accountant shall not be entitled to audit the accounts of enterprises or companies in which* the CPA *has a direct or indirect interest, as specified in the executive by-law*s. In addition, Item 5 in the Executive Statute explains Article 13 in detail, identifying certain improper relationships between auditors and their audit clients. These relationships may affect auditors' objectivity and independence and may result in auditors issuing biased audit reports. Accordingly, an auditor is forbidden to provide audit service to businesses where:

- the auditor is a partner or relative up to the fourth degree to one of the founders or members of the board of directors of the business
- the auditor participates in establishing the business or holds a position as a director or provides NAS to the business, except zakat and tax services, which has to be pre-approved by the AGM.
- the auditor owns substantial shares in a joint stock company, which is a proposed audit client, and if the engagement is accepted, the shares must be divested
- the auditor is a partner of the business or a partner to one of its executive managers or its main shareholders
- the auditor is a guardian of a trust or trustee on an inheritance where the trust has shares in a proposed audit client
- the auditor is a director of a business that has the same industry activity as the audit client.

The Act identifies penalties at Rules 28 to 33; however, it identifies only risks that prevent auditors from providing audit services in the case of certain client relationships; there are other circumstances where auditor independence is at risk such as when auditors provide NAS for their audit clients. Further, the Act does not elaborate on expressions such as direct and indirect interests, substantial shareholdings, and types of NAS. Whilst the Act does not elaborate on these matters, there is an obvious area of misinterpretation left which can be exploited by auditors and their clients on the cost of financial information users.

2.8.4 Code of Ethical Conduct (SOCPA)

The Professional Code of Ethical Conduct of SOCPA, issued in 1994, provides principles and rules related to auditor members. Principle 4 *Objectivity and Independence* relates to auditor independence. Its principles are summarised as follows:

- Objectivity and independence are features of auditing. Objectivity relates to neutrality, professionalism and no conflict of interest regarding the client. Any relationship that appears to impair objectivity and independence is to be avoided.
- Auditors providing NAS, in the form of opinion, zakat and tax services, management advisory services, preparation of financial statements, internal audit service, and training services must ensure that all services are fully and professionally completed, maintain their objectivity and be free from any influence from others.
- An auditor should also constantly evaluate client relationships and social responsibilities. An auditor providing services has to be independent in fact and maintain independence in appearance, and when providing NAS, has to maintain objectivity and avoid any conflict of interest.

SOCPA subsequently issued 17 rules for auditors including *Rule 101 Independence* to reinforce the ethical conduct code, which states that *an auditor must be independent when* *providing audit service according to* (SOCPA) *regulations and articles related to the profession.* Concerning impairment of auditor independence, this rule repeats the SAA's ruling by stating that auditor independence is impaired when auditors have direct or indirect relationships with their audit clients during the audit. It also identifies a list of relationships similar to the list identified in s2.8.3, the Statutory Accountants Act, with the addition of a financial relationship where an auditor obtains a loan from a company they audit, or an executive or substantial shareholder of a client. Despite the importance of this type of relationship between auditors and their audit clients, which may affect auditor independence, it was not mentioned in the SAA or the Company Act. Concerning NAS, the Code identifies three types of NAS that auditors can render to their clients but not to their current audit clients. These are consultancy services, accounting services and zakat and tax services[11].

2.8.5 Standard of Impartiality, Objectivity and Independence

The standard of impartiality, objectivity and independence, issued by SOCPA states:

2/1/1 an auditor must be completely independent in all matters related to the audit and must also maintain impartiality and objectivity when assessing audit evidence and when giving an opinion about the financial statements.

2/1/2 an auditor must avoid the perception of doubt as to the auditor's independence, impartiality or objectivity.

2/1/3 an auditor must guarantee the independence, impartiality and objectivity of the audit team in charge of auditing the financial statements of the audit client.

2/1/4 an auditor must not give an opinion about the financial statements of a client if it is discovered that an audit team member is not independent.

2/1/5 an auditor must document that the audit team is independent from the audit client.

The standard defines auditor independence in both fact and appearance, meeting international independence standards. However, in terms of regulating auditor independence, the standard is not comprehensive in all situations relating to risk to auditor independence. The matters raised in the standard focus on reducing an auditor's economic dependence on the audit client, thus the potential of losing a client. Auditor independence risk is especially high when the auditor's opinion about the client's financial position adversely differs from the client's expectations.

[11] Zakat and tax service was allowed to be rendered to the audit client in 1998.

2.8.6 Summary

This review of the regulations and guidance governing auditor independence shows that all regulations prevent auditors from providing NAS to their audit clients with the exception of tax and zakat service. On reflection, it appears the exception relates to an auditor's comprehensive knowledge of the client's financial status if this form of NAS is provided. A second reason may involve the perceptions of the authorities: that tax and zakat services are not in conflict with audit services, in fact they are complementary. There is a third point, that the auditing firm, as professionals, facilitate the correct payment of taxes and zakat.

The conclusion from this review is that regulators failed to consider the benefits to companies and stakeholders when auditors provide NAS, especially in the context of a developing country like Saudi Arabia where there is a limited number of experienced and well-known accounting firms. Another issue is that the provision of all types of NAS may affect auditor independence; however, the regulations failed to identify the types of risk to auditor independence and the significance of these risks. Some forms of NAS may have a lesser impact on auditor independence, whilst assisting audit clients to overcome disputes in a difficult judiciary environment, thus, it is important to consider the points of view of all stakeholders.

2.9 Chapter Summary

This chapter provides a background review of the context of the research. It gives a broad overview of the nature of the country including the political and legal systems and how such systems interact with the accounting and auditing profession. Further, the economic development and the financial structure including the finance industry and the equity market are presented in order to show the influence on the development of the accounting and auditing profession. A historical development of the accounting and auditing regulations are then described with the focus on auditor independence and the provision of non-audit services. The next two chapters present the literature review on auditor independence and the provision of NAS from two aspects: theory development and empirical findings.

Chapter 3 Review of Auditor Independence

3.1 Introduction

This chapter reviews the literature on auditor independence from two aspects: theory development on the phenomenon, and research exploring frameworks for auditor independence. In addition, an analysis of regulatory frameworks in selected countries is provided. Whilst the following chapter reviews the empirical research on the impact of non-audit services (NAS) on auditor independence, this chapter considers the future discussion from a theoretical perspective.

Structuring these discussions, the chapter is organised into four major sections. Initially, extant definitions of auditor independence are presented to extract, or distil, its essential qualities for this thesis. The second section reviews the concept of auditor independence, then, to place these matters in context, the third section explores regulatory auditor frameworks in selected countries. The fourth section discusses the relationship between auditor independence and the provision of NAS and frameworks to manage this relationship.

3.2 Principles of Auditor Independence

The construct, definition, contributing factors, social paradigm, personal attributes, and quality standards of auditor independence challenge researchers' analyses. Over the decades, authors of financial, scientific, and social disciplines presented their interpretations of the phenomenon and this body of knowledge forms a web of theory, as researchers adopt findings and incorporate work of other disciplinarians into their theses.

To address this wealth of knowledge, although with some overlap, the following discussion explores the principles behind the construct and the research contributing to its evolution.

3.2.1 Definition

Independence, as defined, is that state which is *not influenced or controlled in any way by other people, events or things* (Cambridge International Dictionary of English, 1995, p.720). This definition, as it relates to professional integrity, embodies characteristics selected by individuals or committees within each discipline to meet behavioural or performance objectives relevant to their profession. Independence, as a professional standard, reflects self-reliance and it is essential that professionals should not subordinate their judgement to their clients' views (Carey & Doherty, 1966). Further, it is the right of all beneficiaries to receive accurate and independent professional opinion or advice (Moore, Tetlock, Tanlu & Bazerman, 2006).

In the auditing context, Carey and Doherty (1966) refer to the importance of a precise definition for independence, noting that semantic issues occur in the absence of definitions of terms. The authors (Carey & Doherty, 1966, p. 38) define independence as *avoidance of situations which would tend to impair objectivity or permit personal bias to influence delicate judgments*. Thus a definition for auditor independence requires agreed standards for the terms maintaining objectivity and avoiding personal bias.

Other authors argue that a definition for independence is of lesser importance, that auditors cannot be independent from their clients. This view is expressed by Dopuch and Sunder (1980, p. 16), who opined *Definitions, no matter how carefully worded, cannot bear the burden of the struggle for economic advantage between various interest groups*.

3.2.2 Conceptualisation

Auditor independence differs according to individual and professional perspectives, including separate interpretations for academics and practitioners. Conceptualising auditor independence through the identification of contributing factors has engaged debaters for decades (e.g., Shockley, 1981; Gul, 1989; Beattie, Fearnley & Brandt, 1999). Thus, there is no basis for agreement that auditor independence is inherent in the commercial nature of the auditor and client relationship. This point is emphasised by the United States' Securities and Exchange Commission (SEC), which, researchers find, does not clearly define auditor independence (Antle, 1984; Elliot & Jacobson, 1992; Jenkins, 1999; Kinney, 1999; Beeler & Hunton, 2003). The finance industry in the US is subject to regulatory guidelines designed to maintain auditor independence and to protect stakeholder interests. However, due to the absence of a formal theory or a viable and comprehensive framework for auditor independence, the evolving nature of the auditor and client relationship requires continual regulatory amendment. Antle (1984, p. 1); however, reported that *At least since the Securities Acts, independence has been the focus of almost constant controversy, debate and analysis. Yet the phrase* auditor independenc*e traditionally has had no precise meaning*.

3.3 Independence Research – Applied and Theoretical

The following discussion of the legislation, structures, and theories relating to auditor independence illustrates the evolution of enquiry. Due to the breadth and volume of the data, the material is clustered according to theme.

3.3.1 Antecedents

Over eighty years ago, in part response to issues of accounting probity raised by the 1929 stock market crash and the ensuing Great Depression, the United States' legislature enacted the Securities Acts of 1933 and 1934, which required auditors to act independently of their clients (Bartlett, 1993). Auditor independence is the subject of decades of deep philosophical and empirical research, yet the concept remains unclear and subjective (Elliott & Jacobson, 1992). Whilst US legislation is replete with regulations and guidelines to address auditing situations and practices, the absence of an accepted and established quality standard auditing environment generates yet more regulatory obfuscation when new practices arise that circumvent auditor independence (Elliott & Jacobson, 1992).

The inability over the decades to establish a standard for auditor independence is, according to Carey and Doherty (1966, p. 39) *that independence cannot be defined with precision is that it is primarily a condition of mind and character.* Wolnizer (1987) agrees, commenting that auditor independence is not only a technical concept but also a cognitive and cultural matter. These perceptions are consistent with the early views of audit organisations in many countries like the United States, United Kingdom, and Australia, where auditor independence is observed as a psychological state. These views were embodied by the American Institute of Accountants[12]in its 1947 Tentative Statement of Auditing Standards as *independence is an attitude of mind, much deeper than the surface display of visible standards* (Carey & Doherty, 1966, pp.39-40). Decades later, the Institute of Chartered Accountants in England and Wales (ICAEW), in its 1985 Guide to Professional Ethics, defined auditor independence as *an attitude of mind characterised by integrity and objective approach to professional work*. This discussion concerned the cognitive interpretations of auditor independence, or independence-in-fact; however, attention now turns to the professional relationships between auditors and their clients and the manner by which this relationship is perceived by stakeholders.

[12] Became The American Institute of Certified Public Accountants (AICPA) in 1957.

A construct for independence - standards, principles, or practices – eludes stakeholders. Power (1997, p 132) states *There is a deeply held view that without independence, audit has no value*. Nevertheless, other researchers take the pragmatic view that professionalism in auditors, that is, their independence, should be accepted as part of a fee-for-service although complete independence cannot be guaranteed (Bazerman et al, 2002; Page & Spira, 2005). In general, users of audited financial statements expect auditors to be totally independent from their clients; however, further service-related relationships with a client may risk users' acceptance of professional probity on behalf of the auditor. This is a cognitive view, that personal attributes affect the interpretation of information, which amounts to a *self-serving bias* (Bazerman et al, 2002).

To maintain public confidence, auditors must continually assess their standing in the community. Any reduction in confidence in the auditing profession will immediately reflect a lack of confidence in audited financial statements, leading to an overall decline of trust in capital markets. Thus, auditors are of value to capital markets only through the maintenance of integrity in client relationships.

From a social science perspective, audit independence is depicted as an individual's belief mechanism extrapolated to a group of audit service providers who codify a set of beliefs and practices into an organisation. A high principled-approach to auditor independence is a basic tenet of the services offered by the firm to the client market. From a structural approach, a regulatory or self-disciplining framework binds its members to a set of protocols that determine auditor independence; or market forces determine the outcomes of perceived auditor deficiencies where regulations are not breached.

3.3.2 Social Interpretations

Traditionally, professional auditor independence was classified by two facets: independence-in-fact and independence-in-appearance. Higgins[13] (1962) earlier defined these two types of auditor independence: independence-in-fact refers to an auditor's objectivity, the quality of disregarding personal advantage; and independence-in-appearance means auditor's freedom from potential conflicts of interest, which tend to shake public confidence in his/her independence-in-fact. Since independence-in-fact is a state of mind, it cannot be observed or evaluated by observers; so, over the years the emphasis in the profession has been on maintaining independence-in-appearance. Thus, financial and other relationships between

[13] A former chairman of the AIPCA's Committee on Professional Ethics.

auditors and their clients are continuously subjected to extensive examination; and, in the view of an objective observer in possession of all the facts, those relationships conceivably clouding auditor independence are discarded (Magill, Previts & Robinson, 1998).

Social Behaviourist Approach Drawing on personal and organisational integrity as the benchmark of independence, researchers (e.g., Carey & Doherty, 1966; DeAngelo, 1981b; Knapp, 1985) use terms including objectivity and integrity. For an example of integrity, DeAngelo (1981b) states audit quality is enhanced when auditors discover a breach in the client's financial statements, and report the breach. Auditor independence is defined by the author as the conditional probability of reporting the discovered breach.

Nevertheless, Bazerman, Loewenstein, and Moore (1997, p.90) state that *it is psychologically impossible for auditors to maintain their objectivity because audit failure is expected even with the most honest auditors.* The researchers show that professional independent assessment may be skewed through personal attitudes or incentives in other areas such as law or medicine. This does not imply that the practitioners are corrupt; nevertheless, biased judgments prevent purely impartial objective decision-making (Bazerman, et al., 1997). The point holds equally for auditors, thus, although important, auditor independence may not be absolute, but a matter of degree.

3.3.3 Structural Interpretations

To clarify auditor independence beyond the social or cognitive approaches, many researchers explored regulatory and industrial factors to build a construct (Mautz & Sharaf, 1961; Higgins, 1962; Carey & Doherty, 1966; DeAngelo, 1981b; Flint, 1988; Elliott & Jacobson, 1992). The following discussion explores the protagonists of this theme, noting how the debate evolved over the last half-century.

Professional Perspective Mautz and Sharaf (1961), for example, who acknowledged that independence must be clearly perceived, developed a conceptual framework by recognising two components of auditor independence. The first component is practitioner-independence, the state-of-mind factor, and related to the audit function. Thus auditors have cognisance of independence when planning the audit program, reviewing and verifying audit evidence, and preparing the audit report to an appropriate standard. Three dimensions related to the practitioner-independence were identified by the authors (Mautz and Sharaf, 1961, p. 206):

- programming independence, which is freedom from control or undue influence in selecting audit techniques and analytical procedures and in the extent of their application.

- investigative independence: freedom from control or undue influence in selecting areas, activities, personal relationships and managerial policies to be reviewed.

- reporting independence: freedom from control or undue influence in stating facts, recommendations or opinions derived from the audit function.

The second component is professional-independence, which represents stakeholders' perceptions of independence. Mautz and Sharaf (1961) suggest that the profession should identify situations that will make the financial statements users perceive auditors as independent professionals. The difference between these two components is that the first, practitioner-independence, requires auditors individually to judge themselves using a set of situations that may impair their independence, whereas the second, professional-independence, recognises the importance of the perceptions of users of the financial statements for the whole profession.

The framework of Mautz and Sharaf (1961) contributes to the ongoing independence debate; however, there are aspects that require further investigation. The authors did not clarify the manner by which auditors can express their independence to users. Whilst there are regulatory instruments in each country to control procedures relating to the auditor-client relationship, such controls are designed to control a specific situation (Elliot & Jacobson, 1992). Further, Mautz and Sharaf (1961) did not identify the terms *users of financial information* or *public users* as stakeholders, especially the latter. A definition of public users of financial information was proffered by the AICPA (1965): reasonable observers who know all the facts. In addition, other researchers built on this concept to differentiate general users. Reckers and Stagliano (1981) used the term *sophisticated users* to define that group with a greater understanding of accounting terminology and practices.

Whilst the personal integrity approach dominated debate mid-century, Shockley (1981) used a structural approach to identify areas of significance to independence, selecting four conditions pertaining to an auditing firm that could impact the outcome of their audit services: competition; non-audit services; audit firm size, and audit tenure. These four factors were found to affect auditor independence; however, they are not the only factors that affect auditor independence. Thus, with the absence of a precise definition of auditor independence, achieving a broad framework of auditor independence seems difficult.

Capital Market Theory Auditor independence is related to capital market theory according to Watts and Zimmerman (1986), who differentiated between competence and independence of auditors. Competence, as they stated, depends on the probability that the auditor will discover a given breach; however, independence depends on the probability that the auditor will report this breach. This argument underlies stakeholders' reliance on auditor probity to disclose irregularities in audited reports and statements, and is consistent with DeAngelo (1981b) who stated that, for the capital market to value the auditor's opinion, auditors need to appear independent to the financial statements' beneficiaries.

Financial statement users' expectations for complete violation disclosure by auditors, however, should be tempered by the difficulties encountered by auditors in achieving absolute independence, as DeAngelo (1981a) defines auditor independence as the conditional probability of reporting a discovered breach of contract. The author argues that auditor independence may be impaired when auditors earn client-specific fees, which provide an incentive not to report the discovered breach to retain the client. The relative strength of this incentive depends on the significance of the client to the auditor's portfolio. The client-specific fee-for-services leads to the practice of setting audit fees below the market on initial audit engagements to retain the client (DeAngelo, 1981b). The Cohen Commission (1977, reported in DeAngelo, 1981a) adds that this practice is manifested either as a receivable account or as an unpaid audit fee and it impairs auditor independence-in-appearance.

In an early single-period model of auditor independence, Antle (1982) explores the independence issue when the auditor is formed as an economic agent. In this model, Antle (1982) places the auditor as the client's agent, as the audit enhances the market value of the client's documentation. In this model, clients have incentives to misrepresent the financial statements of the company; and with the absence of some form of control, the auditor is not in a position to seek out and report any breach of financial standards. Antle (1982) argues that, as this is the approach taken to describe the behaviour of owners, managers, and investors, it also relates to the behaviour of auditors. Assuming that ethical and legal responsibilities of the auditor and client are inherent, the model portrays a dichotomy, which is inherently unstable.

Independence Risks and Safeguards The theory of economics of organisation was later employed by Antle, Griffin, Teece & Williamson (1997) as an economic analysis of auditor independence. The principle underlying this theory is that organisational structures in a capitalist society are the results of economies of scale that deliver value to clients. In this construct, auditor independence is a property of auditors' interests; it is not, therefore, in their best interests to compromise independence. Different incentives, institutional and personal, may affect the interest of an auditor. For instance, audit firms invest in reputation, technology, audit methodology, and economies of scope and scale; and these investments lead firms to protect their reputations for independence. Thus, users of financial statements are to a degree protected by auditors' self-interest in this regard. The corollary is that larger audit firms can absorb greater risks to their independence, or that of their individual representatives, than can smaller firms; and small audit firms do not have the same ability to absorb loss of clients.

A framework of auditor independence by Johnstone, Sutton, and Warfield (2001) seeks to explain the manner by which certain direct and indirect incentives, and judgment-based decisions affecting independence risk, interact with a number of factors to affect actual or perceived audit quality. The framework consists of four aspects: the environmental conditions to create independence risk; the mitigating factors which reduce independence risk; the effect on stakeholders if the mitigating factors fail; and the actions recommended by the audit profession, regulators, and researchers.

The first aspect shows the necessary environmental conditions that create independence risk and reduce audit quality. These environmental conditions are the incentives (direct and indirect) that create independence risk, and the judgment-based decision situations that allow independence risk to reduce audit quality. The framework does not imply that the existence of a relationship (financial or non-financial) between an auditor and a client affects audit quality; however, a judgment-based decision situation has to emerge with an existing relationship to create an independence risk, which may reduce actual or perceived audit quality.

The second aspect identifies five factors for safeguards to mitigate independence risk: corporate governance; regulatory oversight; auditing firm policies; audit firm culture; and individual auditor characteristics. These safeguards have a major role in preventing auditor and client relationships from creating independence risk. The third aspect is how stakeholders can be affected by independence risk. Johnstone et al (2001) identify six groups of stakeholders who may be affected by independence risk: audit clients; shareholders; creditors; individual auditors; the audit profession; and regulators. The last aspect of this framework refers to the actions that the audit profession, audit firms, regulators, and researchers can take to maintain independence. The framework Johnstone et al (2001) presented identifies risks to auditor independence and safeguards to mitigate those risks. However, the framework focuses on actual auditor independence, and does not discuss the perception of auditor independence by users of financial statements. Auditors need a strong independent presence in the market-place, acknowledged by stakeholders to counter material risk to their corporate reputations.

A later study on auditor independence risk (Mock, Srivastava & Turner, 2006) develops a closed-form model to assess the role of risk to auditor independence as well as the role of risk-mitigating safeguards. They consider a framework recognised by a number of audit authorities including the International Federation of Accountants (IFAC) and the Institute of Chartered Accountants in England and Wales (ICAEW), investigating interactions among the key variables that affect auditor independence. According to the authors, independence risk is the product of three factors: risk that an auditor has an incentive to be biased in favour of an audit client; risk that the auditor has an inappropriate attitude which may lead to such bias; and risk that there are opportunities for the auditor to benefit from being biased in providing audit opinion.

Options to Independence A model described by Taylor, DeZoort, Munn, & Thomas (2003) establishes reliability in fact and appearance as a cornerstone of the profession, rather than auditor independence in fact and appearance. This framework is based on three foundation elements to control subjectivity in auditors' judgments and decisions: independence; integrity; and expertise. The authors argue that auditor independence is not applicable because it is surrounded by three primary sources of confusion including definitional inconsistency, referring to the various definitions of auditor independence; operational inconsistency, that is, the issue of interpreting auditor independence in authoritative pronouncements; and inconsistency in implementing auditor independence, which appears in the inability to achieve absolute independence in fact and appearance. Their framework replaces independence as one of three necessary conditions, along with integrity and expertise for maximising auditor objectivity and eventually, auditor reliability. Thus, they define auditor reliability as *a condition where stakeholders consistently find the auditor's work and opinion credible and dependable* (Taylor et al., 2003, p. 258). However, their framework has never been implemented, thus it is difficult to draw a conclusion regarding its practical applicability.

Independence as a Construct Later, Elliot and Jacobson (1992) amalgamated the social and structural approaches into a construct, and then portrayed independence as an empty vessel, that is, it is created by an absence of bias, not the absence of bias itself. This theme was taken up by AICPA in 1997, referring to independence as an absence of interests that create an unacceptable risk or bias. Similarly, a private group in the United States, the Independence Standards Board (2000, para. 3), defined auditor independence as *freedom from those pressures and other factors that compromise, or can reasonably be expected to compromise, an auditor's ability to make unbiased audit decisions*. Thus, over the years, researchers moved the definition's focus from structural and social conditions, finally opting for an approach whereupon a quality audit environment is created from the absence of undue influences on the audit procedure.

3.3.4 Summary of Cognitive and Structural Interpretations

The discussion of the literature to this point shows that researchers first viewed auditor independence as cognitive, in this case, a professional behaviour of an acceptable standard, or independence-in-fact. This concept evolved in the literature from an individual characteristic of auditor independence to a tenet of accounting practice. Independence-in-appearance is based on users' perceptions; equal to professional integrity, and therefore both are necessary to create the auditor's objectivity and integrity when auditing financial statements. Risk factors are discussed which can compromise auditor independence and lead to stakeholder indecision when making investment decisions.

A range of models is presented, as researchers portray aspects of auditor independence from various perspectives. Whilst useful in describing independence themes from a principled or theoretical viewpoint, these models are not successful in incorporating variations sufficient to describe the phenomenon. Moreover, some of these models remain to be tested.

3.4 Legal and Professional Frameworks

In many countries, professional organisations and governmental agencies recognised that auditor independence, both the ethical and the professional aspects, is essential to auditors, and users of audited financial statements. Auditor independence is recognised as the cornerstone of the auditing profession, the foundation for the public's trust in the audit function. The concept is an important element of the stock market, as investors rely on audited financial statements when making their investment decisions; the corporate annual report is an important source of information for investment decisions (Meyer & Stanga, 1981).

Audit Risk Model: There was something of a seismic shift in the accounting profession's attitude to auditing and NAS in the late 1990s. Jeppesen (1998) noted a major change in the accounting firms' business models to incorporate new business strategies, in this case business process re-engineering[14]. *These firms aggressively promote an ever increasing line of consulting services, making auditing a relatively marginal service* (ibid. p517). The author opined that the auditor's real clients are the users of the audited financial statements and not restricted in focus to corporate management or the board, as representatives of the shareholders,

Auditing evolves to meet the needs of the client. If *the client* is in fact the users of audited financial statements, then it is their needs that must be met by the audit process, not just those of the corporation which may gain benefit. Jeppesen reviewed the various models for audit; the physical audit, the balance sheet approach; the systems audit, the examination and evaluation of internal control systems, and lastly, the audit risk model. The audit risk model is embodied in International Standards on Auditing (AS200) issued by the International Auditing and Assurance Standards Board. It concerns the following threats:

- Inherent risk: the possible presence of a material misstatement of an assertion in the financial statements, without taking into account the effectiveness of the related internal controls
- Control risk: a material misstatement as described in inherent risk will not be prevented or detected within a reasonable time by the client's internal control system
- Detection risk: a material misstatement relating to an assertion will be not detected by the auditor's substantive testing.

The audit risk model places acceptable risk as the auditor's assessment of the product of the three forms of risk; thus:

Audit risk = IR * CR * DR
where IR = inherent risk, CR = control risk and DR = detection risk.

Whilst the audit model remains as a guide to an auditor's assessment of risk, Houston, Peters and Pratt (1999) explored situations where material risk was discovered and the auditor's response examined. Their findings were that the ability of the audit risk model to describe auditor behaviour and the inclination of auditors to charge a risk premium depended

[14] Business process re-engineering: Initially, the process of removing processes that do not add value, rather than using technology to automate the process (Hammer 1990).

upon the nature of the risks present in the audit. In the presence of errors, the audit risk model adequately described audit-planning decisions; in the presence of irregularities it did not.

Summary Public criticism of perceived auditor independence deficiencies impelled legislators, national and international professional organisations such as AICPA, US SEC, and IFAC, to formulate frameworks of standards and procedures to manage auditor independence. In this section, a review of selected regulatory frameworks is provided (Vanasco, Scousen & Santagato, 1997). These regulatory frameworks are indicative of those developed by legislators and professional organisations in many other countries.

3.4.1 Auditor Regulations and Principles: USA

As the dominant financial power, the USA traditionally determines the thrust of regulatory and professional oversight of auditing principles and practices, although this is based on original European models. This section presents the initial formation of principles for auditor independence in the US and the events that lead to the current regulatory framework, and self-disciplining precepts of their professional organisations. The outcomes for deliberations on auditor independence in USA are significant, as they form benchmarks for international organisations and thus are adopted world-wide.

US Securities and Exchange Commission The US Securities and Exchange Commission (US SEC) continues to stress the importance for auditors to remain independent from their audit clients. Maintenance of auditor independence protects the interests of investors and other stakeholders who rely on financial statements produced internally by the client firm, and audited externally.

In November 2000 (effective date: 5 February, 2001), the SEC revised its regulations regarding auditor independence for the first time since an amendment in 1983 (US SEC, 2000). Initially, the revised regulation retains the general understanding of auditor independence, based on an attitude of objectivity, and lack of bias. An objective attitude refers to independence-in-fact, and a lack of bias to independence-in-appearance. Accordingly, auditor independence is based on two complementary goals: objective audits, and investors' confidence to that end. Thus, financial statements' accuracy is insufficient; public perception of accuracy is necessary for stakeholders to rely on these statements when making decisions (US SEC, 2000). The revised regulation of auditor independence, outlined in a preliminary note, takes into account four governing principles to determine whether a particular relationship exists, or account for the provision of NAS to audit clients (US SEC, 2000):

- creates a mutual or conflicting interest between the auditor and the audit client;
- places the auditors in a position of auditing their own work product;
- results in the auditor's acting as management or as an employee; and
- places the auditor in a position of being an advocate for the audit client.

The 2001 revision was implemented for a variety of reasons; an increase in the provision of NAS by audit firms, and changing service structures between audit and accounting firms and their clients: strategic alliances, co-marketing arrangements, and joint ventures. A further reason is that client firms are hiring auditors, or their family members (US SEC, 2000). These matters increase the business relationship, or foster social relationships between the auditor and the audit client, in turn compromising the independence of the auditor organisation and its representatives. To maintain professional auditor integrity, the US SEC amendment focused on the provision of non-audit services to audit clients; the financial and employment relationships with audit clients; quality control; and the disclosure of fees for NAS. Objections from the profession for the restrictions were countered by the US SEC (2000) issuing the revisions as a preliminary note, in preference to the regulation itself (Palmrose & Saul, 2001).

The US SEC regulation defining financial and employment relationships, previously prohibited an audit firm's partners and their families, including partners removed from client work, from investing in an audit client. However, with the 2001 revision, only partners who work for a specific client or other audit firm representatives who may influence the audit are prohibited from investing with the client. Further, the revision reduced the group of individuals within audit firms whose families are so affected; however, it prevents audit firms and their employees from any direct or indirect business relationship with audit clients, except the provision of professional services. The US SEC acknowledged that not all NAS affect auditor independence, thus restrictions were placed by the revision on eight NAS to their clients: bookkeeping; financial information systems design and implementation; actuarial services; management functions and human resources; broker-dealer services; valuation services and fairness opinions; internal audit services; and legal services.

The US SEC's revision concerning NAS is consistent with the findings of many researchers who find no evidence that the provision of NAS to audit clients threatens auditor independence (Titard, 1971; Reckers & Stagliano, 1981; Ashbaugh, LaFond, & Mayhew, 2003). The US SEC also requires its member firms, that is, its registrants, to disclose audit and non-audit fees for all consulting services provided by their external auditors: annual audit fees; fees related to the provision of financial information systems design and implementation; and fees related to all other non-audit services including tax-related services. Further, registrants are required to disclose whether their audit committee considered whether the provision of the information technology services and any other NAS is compatible with maintaining auditor independence. Finally, registrants are required to make disclosure of any person other than the audit firm's full-time employees who performed more than 50 per cent of the client's audit.

The amendment supports audit committees in their corporate governance role; in particular, audit committees in public companies are a crucial means through which corporate boards oversee the objectivity and reliability of the company's financial statements. In addition, audit committees facilitate communications between the company's board, its management, and its internal and external auditors on major accounting issues and policies, which should enhance the registrant's corporate governance. Thus, this amendment is believed to advance the understanding of auditor independence and play a major role in protecting the interest of investors and other stakeholders.

The US SEC 2001 revision nevertheless has its critics. Palmrose and Saul (2001) note that the supporting documentation for the preliminary note did not provide empirical evidence of abuse of auditor independence; also, that audit clients expressed little concern regarding auditors providing NAS. The authors note that the US SEC may be focusing on the interests of those with equity in the companies, in preference to the interests of management. This means that although providing NAS for an audit client may have some benefits for that client, the interest of the shareholders must be protected.

In the US, corporate defaults such as Enron are partly the result of a conflict of interest that can occur between client management and the external auditor. These events are the consequence of disclosure issues, omission of governance by the board of directors, and external auditors who do not fulfil their responsibilities by disclosing financial irregularities. In response, the US SEC updated its regulations by implementing several sections of the Sarbanes-Oxley Act of 2002 in its 2003 final regulation (US SEC 2003). To maintain auditor independence, this update enhanced auditor independence, and required additional disclosures on services provided to public companies by their auditors. The areas affected were the scope of services provided by the external auditor; audit committee role in the engagement; partner rotation; employment at audit client; expanding disclosure requirements; and communications with audit committee.

To strengthen auditor independence and protect the interests of stakeholders, the 2003 US SEC amendments addressed a number of issues, including a client company's audit committee administration of the audit engagement. The audit committee manages all relationships between the company's management and an auditor, approving and overseeing all audits and allowable NAS. Matters of disclosure and obligation are another focus of the regulations and registered companies must disclose all audit and NAS information, including fees, relating to services provided by the auditor.

American Institute of Certified Public Accountants The precursor of AICPA, The American Institute of Accountants, recognised auditor independence in its constitution in 1941 (AICPA, 2001), when it became part of its Code of Professional Ethics (Vanasco et al, 1997, p. 499):

> A member or associate shall not express his opinion on financial statements of any enterprise financed in whole or in part by public distribution of securities, if he himself is the actual or beneficial owner of a substantial financial interest in the enterprise or if he is committed to acquire such an interest; nor shall a member or an associate express his opinion on financial statements which are used as a basis of credit, if he is himself the actual or beneficial owner of a substantial interest in the enterprise or if he is committed to acquire such interest, unless he discloses his financial interest in his report.

The ethics statement focuses on the financial interest that may exist between auditors and their clients, especially when auditors are the beneficial owners of their clients. However, the statement does not include other risks to auditor independence, for example, the provision of NAS, or other than financial relationships.

As part of its Code of Professional Ethics, the AICPA has long directed the course of auditor independence, in 1972 issuing a Statement on Auditing Standards emphasising independence, that auditors: should *not only be independent in fact; they should also avoid situations that may lead outsiders to doubt their independence*. It continued: *To be independent, the auditor must be intellectually honest; to be recognized as independent, he must be free from any obligation to or interest in the client, its management, or its owners*. This implies that auditors have to be totally independent both in-fact and in-appearance when issuing their audit report and independence must be perceived by users of the audited financial statements. Finally, in 2001, the AICPA updated its independence statements on financial, family, and other business relationships for consistency with the US SEC and global standards (AICPA 2001).

Public Oversight Board The Public Oversight Board (POB), established in 1977 as an independent private organisation to promote governance, issued a report in 1994, *Strengthening the professionalism of the independent auditor* (POB 1994). This report made recommendations aimed at improving auditor independence and strengthening corporate governance:

- enhancing the independence of the board of directors will strengthen the professionalism of the external auditor, enhance the value of the independent audit and serve the public interest
- board of directors and auditors should be allies in protecting shareholder interests, thus auditors should look at board of directors as the representative of the shareholders to be its audit client and not the company management
- enhancing communication between board of directors and the auditor will have a positive impact on protecting the public interest.

In 2002, the POB issued another report titled: *The recommendations of the panel on audit effectiveness* (POB, 2002). The panel made recommendations regarding auditor independence in two areas, NAS and corporate governance. Whilst not advocating a total prohibition of the provision of NAS to the audit client; it did recommend that the Independence Standards Board (ISB) identify factors that auditors, audit committees and client management should consider when the auditor provides non-audit services to the audit client.

Independence Standards Board The ISB was established in 1997 through cooperation between the SEC, the AICPA, and the largest auditing firms in the US with the aim of issuing independence standards applicable to SEC registrants (Glazer & Jaenicke, 2002). The ISB in 2000 issued a draft of a conceptual framework for auditor independence including the concept and the basic principles for best practice, defining independence as *freedom from those factors that compromise, or can reasonably be expected to compromise, an auditor's ability to make unbiased audit decisions* (ISB 2000, para. 4). Although not using the terms independence-in-fact and independence-in-appearance, the definition notes that auditors need to be free from those factors that compromise or can reasonably be expected to compromise auditor independence. Further, the ISB definition omitted to include to whom it can be relied on to regulate factors that compromise independence.

The ISB (2000) supported a threat-safeguard approach which first identified threats to auditor independence and determined their significance; then evaluated the effectiveness of potential safeguards, including restrictions; and lastly, determined an acceptable level of independence risk. The goal of this model was to enhance capital market efficiency by supporting user reliance on the audited financial statements, thus it targeted users of financial statements rather than particular circumstances that may affect auditor independence (discussed at s5.3). However, ISB participants, including the SEC, expressed concern that a threats and safeguards approach allowed auditors too much freedom to make decisions about independence matters. That flexibility could be used to justify an auditor's actions, even if the decision was contrary to existing independence rules. Consequently, the threat-safeguard approach was not adopted by the SEC as it was based on principles and not regulations, and it gave more flexibility to audit firms to justify an expanded relationship with their audit clients (Glazer & Jaenicke 2002).

Further, the Board's central emphasis on users' perceptions of a conceptual framework was questioned by members of its own taskforce.

> They stressed that improved financial statement reliability is the major outcome of an audit. Although enhanced credibility and user confidence are important, they result from improved reliability and should, therefore, not be given equal weight in, or be separate components of, a conceptual framework (ibid. p.330).

Representation on the ISB, which was funded by the private sector, was equally divided between public and private sectors. Its intention from inception in 1997 to its demise in 2000, was to form a conceptual framework for independence standards applicable to the auditors of SEC registrants. However, the SEC was intransigent in first, the Board deliberations regarding independence in appearance; second, the SEC's view that certain NAS were within its jurisdiction, not the ISB's , and third, the Commission was not supportive of the threats and safeguards approach. The SEC pre-empted the ISB, which it saw as an advisory entity, by issuing rules on NAS in 2000; the ISB was subsequently disbanded.

The SEC revised its independence regulations again in 2003, as mentioned above. The threat-safeguard approach, based on principles, was adopted by a number of professional associations, including the International Federation of Accountants (IFAC), ICAEW, and ICAA.

International Federation of Accountants Founded in 1977 (Vanasco et al., 1997), IFAC participated in the ISB conceptual framework for auditor independence (Glazer & Jaenicke, 2002). Accordingly, the IFAC adopted a principle-based conceptual framework for auditor independence similar to the ISB and other models, that is, independence-of-mind and independence-in-appearance (IFAC, 2006). IFAC claims that, as a term, independence may be interpreted to free an auditor exercising professional judgment from all economic, financial, and other relationships; an impossibility (IFAC, 2006). Moreover, risk is subjective; for example, the US SEC independence requirements are based on its perceptions of certain auditor-client relationships created by the provision of NAS, whilst research finds minimal effects on auditor independence. As it is impossible to define all risks to auditor independence, there is a need to identify and apply safeguards to eliminate overt elements of risk or reduce them to an acceptable level. Accordingly, the significance of all types of relationships should be evaluated in a reasonable manner. Thus, the IFAC's conceptual framework is based on principles that can be used to identify, classify, and evaluate all risk factors; then identify and apply safeguards to neutralise risks.

3.4.2 Auditor Regulations and Principles: Australia

In its 2002 revised professional statement on auditor independence, the Institute of Chartered Accountants in Australia (ICAA 2004) defines auditor independence as

- independence of mind - the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity and exercise objectivity and professional scepticism
- independence in appearance – the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's or members of the firm's integrity, objectivity or professional scepticism had been compromised.

This definition of auditor independence is consistent with the IFAC framework of auditor independence and addresses the two types of independence: independence in-fact and in-appearance. This definition takes into account that auditor independence is not absolute, as commercial relationships exist in the contract for the audit. It also acknowledges the requirement for probity in that auditors maintain public respect and confidence. The ICAA's statement of independence was issued in May 2002 after the 2001 Ramsay Report on auditor independence (Ramsay, 2001) and revised in December 2004. The ICAA model differs slightly from IFAC as it includes a mandatory two-year waiting period before a retired audit partner involved in the audit of a client can become a director of that client, while IFAC does not set a specific period.

In 2005, the CPA Australia, and the Institute of Chartered Accountants in Australia (ICAA) established the Accounting Professional and Ethical Standards Board (APESB) to set the code of professional conduct applicable to their members. The APESB replaced the existing Joint Code of Professional Conduct with APES 110, the Code of Ethics for Professional Accountants. The main purpose of the APES 110 is to take account of the revised IFAC Code (APES 110) (see s3.5.2 regarding NAS and auditor independence).

3.4.3 Auditor Regulations and Principles: United Kingdom

The Auditing Practices Board (APB) was established in 2002 to lead the development of auditing practice in the United Kingdom and the Republic of Ireland to:

- establish high standards of auditing
- meet the developing needs of users of financial information, and
- ensure public confidence in the auditing process (Auditing Practices Board 2008.

The collapse of the US firm Enron in 2001 brought into question the role of their auditors, Andersen. Fearnley and Beattie (2004) stated that the occurrence was evidence of systemic failure in the USA regulatory system and raised widespread belief that the auditor had compromised its independence as auditors.

To meet public concern of possible regulatory vulnerability, the UK government set up an enquiry to review its regulations on auditor independence. Of particular interest to the enquiry, the Coordinating Group on Accounting and Auditing Issues, were perceived issues with the Andersen audit of Enron: the firm was earning more from NAS provision than from audit; an office of the auditor and a partner were dependent on Enron's income; and several ex-Andersen staff worked at Enron. These issues were addressed in the USA by the Sarbanes-Oxley Act, 2002 (s.3.5.2). In UK, the principal concerns, given extant regulations, were the rotation of audit firms by the client and the banning of NAS provision by auditors. The Accountancy Foundation Review Board commissioned wide research on the principal issues and developed responses which were used inter alia by the enquiry to make its recommendations to government. These led to significant changes in the UK's regulatory framework, which was directed to the APB.

In 2005, the APB adopted the International Standards of Auditing issued by the International Auditing and Assurance Standards Board (IAASB). The APB decided that it was more effective to contribute to the international effort through the independent IAASB which was then introducing new standards in audit risk. IAASB's host organisation is the International Federation of Accountants (IFAC) in New York.

3.4.4 Auditor Regulations and Principles: Summary

With the exception of the US SEC, the general practice for auditor independence for international and national public and private organisations is to adopt a principles-based model of risk identification and mitigation: the threat-safeguard approach. Although not considered an effective approach to impose independence, it provides a template for elements that may impair auditor independence and means for addressing those elements. However, the US SEC adopted a regulation-based approach, together with four principles to account for risk. The principle-based model of ISB, EC and IFAC identified risk elements including self-interest, self-review, advocacy, familiarity, and intimidation, with the significance of any of these elements determining the level of risk in specific circumstances. Mitigating factors including regulatory safeguards, safeguards within the audit firm, governance procedures of audit clients, and rejection of the appointment if the other safeguards are not sufficient.

3.5 Auditor Independence and NAS

Audit firms offer a variety of services in addition to audit service for their audit clients (Canning & Gwilliam, 1999), benefiting both auditors and clients in terms of cost savings (Arruñada, 1999b), enhancing efficiencies, and improving performance in audits and consulting engagements (Chan, 2004). However, substantial NAS revenue can create a conflict of interest for auditors as it reduces public perception of the audit's quality, a grave issue for auditor independence. In this section, the relationship between providing NAS to audit clients and auditor independence is discussed through identifying NAS and presenting models that address issues arising.

3.5.1 Definition of Non-audit Services (NAS)

Non-audit services are, for the purposes of this study, all services provided by audit firms which do not involve audits, for instance, bookkeeping, tax services, and management advisory services including investment banking assistance, strategic planning, human resource planning, computer hardware and software installation and implementation, and internal audit outsourcing (Jenkins, 1999). According to Kell (1968), NAS form accounting and non-accounting services. The term Management Advisory Services (MAS) used by academics and researchers to represent NAS causes confusion as there are other services not included in MAS, such as taxation and accounting services (Beattie, Brandt & Fearnley, 1996). Thus, MAS are non-accounting or administrative services, since they are outside the traditional scope of the audit and extend beyond the client's accounting services.

The duality in providing audit and NAS to the same client increases the auditor's economic dependence on that client, a conflict of interest and a threat to auditor independence (Mautz & Sharaf, 1961; Colson, 2004). The next section discusses a number of situations related to NAS believed to affect auditor independence, as revenue dependence is not the only cause of conflict of interest.

3.5.2 Independence and NAS Relationship

Identifying the auditor-client relationship is a major aspect receiving considerable attention in the audit independence literature (Goldman & Barlev, 1974; Knapp, 1985; Beattie et al., 1998). Dependence may arise from a variety of factors including financial dependency, or a dependency that could arise from auditing one's own work. With the strong relationship between the perception of auditor independence and the provision of NAS to the audit client (Arruñada, 1999a), the concern in the audit independence literature is whether auditors who provide NAS to their clients are still independent.

Providing audit and NAS and its impact on auditor independence is a critical issue facing the audit profession (Kinney, Palmrose & Scholz, 2004). A major source of controversy about the audit profession is whether audit firms are able objectively to evaluate financial statements while simultaneously providing NAS to their audit clients (Knapp, 1985). The US government's response to the Enron affair in 2001 was swift legisaltion to restore public confidence in the accounting and auditing professions, the *Sarbanes-Oxley Act, 2002* (s3.4.3, Griffin & Long 2007). The Act radically changed the oversight of the auditing profession by creating the Public Company Accounting Oversight Board (PCAOB) to set auditing standards for public companies and by establishing programs of quality control and inspection of public company auditors. The Act also substantially altered the overall scope and quality of an audit.

While some countries, such as US, prohibit auditors from providing a number of NAS to audit clients, other countries, such as Belgium, France, Italy, and Saudi Arabia, prohibited all NAS except tax services, arguing the propensity for a collusive relationship and thus impairment of auditor independence (Arruñada, 1999b; Hudaib, 2003).

For the largest auditors, the proportion of total fees derived from NAS continued an increase that began in the last half-century (Burton & Fairfield, 1982). McNamee, Dwyer, Schmitt, & Lavelle (2000) report that, by the end of the 20th century, non-audit fees represented 51 per cent of the total revenue of the largest audit firms and their consulting services were growing three times as fast as their basic audit services. In a New Zealand study, Hay, Knechel & Li (2006) reported that non-audit fees increased from 39.5 per cent in 1996 to 49.8 per cent in 2000. The former chairman of the US SEC, Arthur Levitt, saw this trend as a massive conflict of interest between auditors' duties and the consulting revenues auditors receive from audit clients, warning the profession against the practice of discounting financial statement audits to attract profitable consulting engagements (McNamee et al., 2000).

Empirical studies (Gul, 1989; Reckers & Stagliano, 1981; Jenkins & Krawczyk, 2002) support the notion that NAS increases auditor independence[15]. In addition, Goldman and Barlev (1973) state that NAS makes the auditor more useful to the client and thus increases the auditor's relative power over the client. As a result, the auditors are better able to resist pressures and therefore remain independent. Moreover, it is argued that banning NAS may have an unfavourable effect on the quality of the audit through limiting the knowledge and skills of auditors (Lennox, 1999). This view is supported by other researchers; for instance, Arruñada (1999b) argues that providing NAS to audit clients improves efficiency for auditors since audit and NAS use the same sets of information, and auditors already have a good knowledge of their clients' businesses.

The opposing research view is that NAS impairs auditor independence. Mautz and Sharaf (1961) pointed out that audit firms rendering NAS may engage in decision-making, adding, *once advice leading to business decisions is given, a mutuality of interest between the consultant and the company begins to develop* (Mautz and Sharaf, 1961 pp. 222-223). However, opposing groups argue that NAS does not involve decision-making and is limited to providing advice only to the audit client; therefore, the independence of the auditor may not be affected (Carey & Doherty, 1966). This view is still arguable because auditors providing advice to their audit clients may not be able to avoid participating in the decision-making process since decision-making consists of several steps involving many internal and external professionals. This is a situation that may affect the relationship between audit firms and their audit clients, which, in turn, affect the independence of audit firms and there are many other

[15] Empirical studies are discussed in Chapter 4.

situations such as when auditors provide bookkeeping and tax services to their audit clients. Providing bookkeeping service may impair auditor independence since auditors are auditing their own work. Providing tax service to the audit client also may impair auditor independence since auditors may act as advocates for their clients.

Despite these distinctions on the impact of NAS on auditor independence, research after the introduction of the US Sarbanes-Oxley Act 2002, takes the argument extraneously to investor and public perceptions of auditor independence. Consistent with Dopuch, King and Schwartz (2003), Davis and Hollie (2008) find disclosure of NAS fees reduces the accuracy of investor perception of auditor independence. Importantly, Davis and Hollie (ibid.) also find that the proportionate level of NAS fees to total fees has a varying impact on investor perception of auditor independence and market behaviour. When investors perceive auditor independence is impaired as a result of the level of NAS fees, more asset pricing inefficiencies occur in the markets.

Further, in a study on changes in the US market for tax NAS, Omer, Bedard and Falsetta (2006) found a strong pre-2002 positive association between NAS in the form of tax fees and higher than expected audit fees weakened significantly in 2002, suggesting that some companies paying high audit fees reduced or terminated auditor-provided tax services in that year. This implied significant change in auditor-provided tax NAS prior to 2003, when separate disclosure of auditor-provided tax service fees was mandated in USA.

In Australia, the *Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Act 2004,* CLERP 9, is the most recent reform to the Corporations Act 2001 (Commonwealth) which governs corporate law in Australia. The Act adopts recommendations of the 2001–2003 HIH Royal Commission in regard to the provision of NAS by auditors. The key proposals, which only apply to listed companies are that the board of directors are to identify all NAS provided by the audit firm and the applicable fees, and all directors (rather than the audit committee as was originally proposed) are to state whether the NAS provided threatens the audit firm's independence including reasons for being satisfied that the NAS do not compromise the auditor independence requirements.

In summary, auditors may have a vested interest in providing such services as this may generate additional income. This potential reliance on additional income can be perceived as a possible risk to auditor independence.

3.5.3 Threats and Safeguards to Auditor Independence

Threats to auditor independence arise from a variety of adverse pressures, activities and relationships, and may emerge in a wide variety of circumstances. The provision of NAS to audit clients has the potential to create a strong relationship between auditors and their clients. Thus, it is essential to identify potential threats since threats represent sources of independence risk (ISB 2000).

A number of independence regulatory frameworks (IFAC; UK; EC; and Australia) adopt a principle-based approach to independence. This approach is based on identifying threats to independence and safeguards, which can be applied to eliminate or minimise threat. These regulatory frameworks identify five types of threats, similar to the principles outlined by the ISB (2000): self-interest, self-review, advocacy, familiarity, and intimidation. Different threats may arise from one set of circumstances. Intimidation does not arise from NAS, it occurs when an auditor is prevented from acting objectively by actual or perceived threats from a client. The other four types of risk relate to the provision of non-audit services to the audit client. A short summary of those threats from the ISB (2000, para. 12) follows.

> Self-interest Threats that arise from auditors acting in their own interests. Self-interests include auditors' emotional, financial, or other personal interests. Auditors may favour, consciously or subconsciously, those self-interests over their interest in performing a quality audit. For example, auditors' relationships with clients create a financial self-interest because auditees pay the auditors' fees. Auditors also have a financial self-interest if they own stock in a client firm and may have an emotional or financial self-interest if an employment relationship exists between an auditor's family member and a client firm.
>
> Self-review: Threats that arise from auditors reviewing their own work or the work done by others in their firm. It may be more difficult to evaluate without bias one’s own work, or that of one’s firm, than the work of someone else or of some other firm. Therefore, a self-review threat may arise when auditors review judgments and decisions they, or others in their firm, have made.
>
> Advocacy Threats that arise from auditors or others in their firm promoting or advocating for or against an auditee’s position or opinion rather than serving as unbiased attestors of the auditees’ financial information. Such a threat may be present, for example, if an auditor or others in the auditor’s firm promote an auditee’s securities.
>
> Familiarity (or trust) Threats that arise from auditors being influenced by a close relationship with an auditee. Such a threat is present if auditors are not sufficiently sceptical of an auditee’s assertions and, as a result, too readily accept an auditee’s viewpoint because of their familiarity with or trust in the auditee. For example, a familiarity threat may arise when an auditor has a particularly close or long-standing personal or professional relationship with an auditee.

After identifying these threats and evaluating their significance, auditors should analyse potential safeguards relevant to the circumstances to eliminate or reduce risk to an acceptable level, as independence is a matter of degree. Potential safeguards include consultation with other professionals or review by a second partner, restricting certain types of relationships or restricting types of NAS that may create such relationships between the auditor and the audit client. According to the threat-safeguard approach, the four sources of safeguards against factors threatening auditor independence are (ISB, 2000):

1. regulatory safeguards created by either legal or professional requirements (e.g., auditing standards, prohibitions, disclosure requirements, ethical guidelines, educational requirements).
2. safeguards within the firm which can be firm-wide or engagement specific, (e.g., quality control and documentation; identification of threats; availability of consultation procedures; internal reviews by independent partners; division of responsibilities; training, staff development and rotation of senior personnel).
3. governance procedures in the company (e.g., corporate governance structure; internal procedures and assurance of having competent employees).
4. refusal to perform by the audit firm when the safeguards available are insufficient to eliminate or reduce the threats to independence to an acceptable level.

3.5.4 Summary

Finally, two points can be mentioned regarding these frameworks. First, these frameworks are not always effectively applied. However, different mechanisms can contribute to these frameworks' effectiveness such as enforcement, a strong culture of fulfilment and ethical standards of behaviour in company boards and audit firms. Second, although the distinction is made between independence-in-fact and independence-in-appearance, this distinction is not followed through into the threats and safeguards. It is therefore not clear that the principle of threats and safeguards relates to independence-in-fact, independence-in-appearance, or both.

3.6 Conclusion

In this chapter, an inclusive review of the regulatory frameworks of auditor independence was presented. The review starts with presenting some definitions of auditor independence in order to clarify the difficulties in defining auditor independence. It was concluded that a lack of agreement on a precise and comprehensive definition of auditor independence limits the ability to develop a comprehensive framework for auditor independence. Next is a discussion of the literature in terms of the interpretation of auditor independence as cognitive, where independence was viewed as a state of mind; as social, in terms of how independence affects stakeholders; and as structural, where a number of factors are believed to impair auditor independence. A review of auditor independence rules and regulations in some countries, such as the US, UK, and Australia, was presented. Two independence frameworks are introduced, the rule approach and the threat-safeguard approach.

Finally, the relationship between auditor independence and NAS was explained, including the definition of NAS, how NAS provision threatens auditor independence, and safeguards presented that mitigate threats to auditor independence. The threat-safeguard framework is explained in greater detail in Chapter 5. The next chapter discusses empirical studies investigating the effect of the provision of NAS on auditor independence.

Chapter 4 Review of NAS Effect on Auditor Independence

4.1 Introduction

The provision of non-audit services (NAS) to the audit client is the main focus of many research studies investigating auditor independence, and the main theme of this study. The impact of economic and regulatory factors on the perception of auditor independence is a matter of extensive research, although a review of empirical studies found no agreement between researchers regarding these factors.

As discussed in this chapter, the conceptualisation of auditor independence is limited within the context of economic rationality, which gives less regard to human motivators, ethics, and philosophy. Nevertheless, perceptions are fundamental to public confidence in financial reporting (Carmichael, 2004). Extant studies and their findings comprise investigations of concepts, such as independence-in-fact, that researchers find difficult to observe, and so the focus of most studies is perceptions of users of financial statements.

This chapter is organised as follows. The research findings fall into three groups, introduced in the first section and elaborated upon in the succeeding three sections. Section five discusses the four classes of threats resulting from the joint provision of audit and NAS including: self-interest; self-review; advocacy; and familiarity threats. The final section is an overall summary.

4.2 Investigations of Concepts

The impact of the provision of NAS to the audit client on perceptions of auditor independence was the subject of empirical studies in many countries over the last forty years, using two different approaches. The first approach, in early studies, took a behavioural perspective. The results of these studies indicate three different findings: negative effect; positive effect; and no effect of NAS provision on auditor independence (e.g., Schulte, 1965; Titard, 1971; Hartley & Ross, 1972; Shockley, 1981; Pany & Reckers, 1983 & 1984; Knapp, 1985; Gul, 1991; Gul & Windsor, 1994; Jenkins & Krawczyk, 2002). Further, these results are subject to potential internal validity threats (Schulte, 1965; Gul & Windsor, 1994) and other limitations relating to the survey questions and participants' characteristics, which compromise the findings. Moreover, each country has specific circumstances that require consideration when conduction a behavioural study. For instance, Quick and Ben-Rasmussen (2005) reported that, in Denmark, familiarity does not affect auditor independence, finding that separation of staff within an audit firm did not appear necessary. The authors interpreted their findings as driven by cultural differences.

Authors in the second approach, used in later studies, adopt the archival method for an objective investigation into the effect of NAS on auditor independence (Wines, 1994; Pringle & Bushman, 1996; Lennox, 1999; DeFond, Raghumandan & Subramanyam, 2002). In some studies, auditors' tendency to issue qualified audit reports is generally used as a proxy measure of actual auditor independence. Other authors examined the characteristics of cases of declared audit failures to investigate the effect of NAS provision on auditor independence (Antle, Griffin, Teece, & Williamson, 1997; Palmrose, 2000). In recent studies, authors explored the association between earnings management or quality, and the provision of NAS to the audit client (Frankel, Johnson & Nelson, 2002; Chung & Kallapur, 2003; Ruddock, Taylor & Taylor, 2006).

The results of all studies examining the relationship between auditor independence and the provision of NAS were themed as follows:

- the joint provision increases the economic dependence and the relationship between auditors and clients becomes too close, as a result, adverse impact on auditor independence may exist (Schulte, 1965 & 1966; Briloff, 1966; Hartley & Ross, 1972; Frankel et al., 2002)
- the joint provision enhances auditor's knowledge of the client company and that such knowledge spillovers increase objectivity and independence (Goldmand & Barlev, 1974; Gul, 1989; Wallman, 1996; Arruñada, 1999b)
- the joint provision has no effect on auditor independence either positively or adversely (McKinley, Pany, & Reckers, 1985; Barkess & Simnett, 1994; Pringle & Bushman, 1996; Hussey, 1999; DeFond et al., 2002).

4.3 Studies Signifying a Negative Effect on Auditor Independence

A number of researchers using survey and archival research methods found that the provision of NAS to audit clients compromises the perception of auditor independence (Schulte, 1965 & 1966; Briloff, 1966; Hartley & Ross, 1972; Frankel et al., 2002). Authors of these studies used data generated from audit pricing, audit opinion decision, audit failures, lending and investment decisions, audit tenure, NAS fees and audit fees, and earnings quality. Responses in survey studies are captured as either simple dichotomous variables (i.e., independent or not independent) or an importance scale (typically a five or seven point Likert scale). However, in archival studies, authors use a variety of models after controlling for a number of variables. Each of these methods is discussed below.

4.3.1 Survey Studies

Schulte (1965) is an early author who, using surveys, investigated the effect of management advisory services (MAS)[16] provision on auditor independence. The researcher's focus was whether an auditor delivering MAS to an audit client creates a relationship viewed as a conflict of interest. The study's participants, sophisticated users of the financial statements, were commercial loan officers, financial analysts, and investment officers, for both insurers and domestic fund organisations. The results were mixed: 43 per cent of the study's participants considered MAS provision impairs auditor independence, whilst a third (33%) reported that independence was not impaired. In fact, about 20 per cent of the latter respondents (independence was not impaired) indicated that their confidence in audit reports was improved. Participants who considered MAS provision impairs auditor independence said that this was based on the risk in the creation of a closer relationship. Participants who did not regard provision of MAS services as degrading independence said that auditors are not involved in the decision-making process, they offer advisory services only, and value highly their integrity, thus they are prevented from accepting any engagement if their independence is threatened. The researcher also discovered a difference between participants from large (60% reported no serious effect) and small organisations (39% reported no serious effect) which the author attributed to large audit firms' auditing and consulting services performed by separate divisions, thus reducing the risk of compromising auditor independence.

In a later survey, Lavin (1976) asked respondents whether independence is impaired in light of two situations concerning the provision of NAS to the audit client: providing bookkeeping services and preparing the executive payroll. Lavin found a difference in perceptions for each service: 45 per cent of loan officers and 47 per cent of financial analysts reported that extensive accounting services impaired auditor independence; however, with less accounting services provided, this percentage falls to 37.

[16] Using NAS is more comprehensive than using MAS to represent non-attest services because MAS does not cover all non-attest services such as accounting services.

Unless in a series, a dichotomous measure ignores the claim that perception of auditor independence is a matter of degree, which may have an effect on the result. This is because independence is only one attribute of the auditor's professional status. Thus, like all attributes of professionalism, independence is a quality that may have a range of values that depends on a user's perceptions of the various aspects of audit commitment (Beattie et al, 2001).

Further, Shockley (1981) investigated the effects of four factors on auditor independence including competition, MAS, audit firm size, and audit tenure. MAS, lacking a comprehensive definition, were interpreted as provision of accounting-related information systems. The participants, sophisticated financial report users from large and medium financial firms, ranked MAS third in a list of factors impacting auditor independence.

Another participant study with corporate directors used NAS components of tax preparation, acquisition review and systems design, and a seven-point scale (Pany & Reckers 1983). Participants were asked whether they agreed with the appointment of an auditor to provide NAS, and, in the event of such an appointment, decide if the auditor remained independent. The findings show that the type of service was highly significant in the participants' responses. This result was inconsistent with Goldman and Barlev's (1974) argument, that NAS provision enhances auditor independence through increased knowledge and understanding of the client.

Pany and Reckers (1984) in a further study compared seven NAS: executive recruiting, actuarial services, purchase acquisition assistance, market feasibility, redesign of an accounting system, recruiting an independent director, and client employment of firm employees. The participants were chartered financial analysts and stockholders. They sought factors that influence participants' responses: the knowledge of the participants, separation of staff performing audit and NAS, and type of service performed. These factors were tested in response to previous authors (e.g., Burton, 1980) who found that impairment of auditor independence was less of a concern with sophisticated users; and that US authorities differentiated between accounting and NAS. Pany and Reckers' (1984) findings showed that, unlike their previous research (1983), the type of NAS was not significant to the perception of auditor independence.

In a contemporary study, a repeated measures design was used to investigate the impact of factors, including MAS, on loan officers' perceptions of auditor independence (Knapp, 1985). MAS provision was set at two levels, nil and 40 per cent, and the findings showed

MAS provision was statistically significant, consistent with Shockley's (1981) findings where similar participants were used; however, there was minimum variance in subjects' judgments on MAS.

Gul (1991), in a New Zealand study, examined loan officers' perceptions on an auditor's ability to resist management pressure when the firm provides MAS to the audit client. The MAS concerned was supply of an accounting system, representing a large proportion of the auditor's combined fees. The findings were that auditors' independence was compromised by the MAS of this scale.

Lindsay (1992) examined this issue in a cross-country study for Australia and Canada, investigating the effect on auditor independence of NAS fees at nil and 40 per cent of audit fees. Findings indicate no country effect; however, NAS was a significant factor, explaining 3 per cent and 2 per cent of variance for analysts and bankers, respectively.

The nature of the business relationship between an auditor and a client, whether it is a prime or sub-contractor or a joint venture agreement, is significant. Lowe and Pany (1995) argue that a joint venture arrangement with an audit client is a direct relationship because both parties share the profits of their combined efforts. The contractual relationship is not direct because audit responsibility or NAS responsibility are both clear and directly compensated. Thus, Lowe and Pany investigated whether an audit firm providing NAS *with*, rather than *for*, an audit client affects users' perceptions of auditor independence. Their findings show that participants view auditor independence favourably when there is a separation of staff performing audit and non-audit services. Moreover, they find that auditor independence, reliability of financial statements and loan decisions are adversely affected by the materiality of the engagement. In addition, the continuity of a business relationship can affect perception of auditor independence, but not the reliability of financial statements, and loan decisions. These results indicate that applying certain safeguards such as staff separation or having non-continuous business relationship rather than a continuous relationship with an audit client may reduce concerns regarding auditor independence.

In 1996, Lowe and Pany extended the first investigation, revisiting the nature of the business relationship with the following differences:

- observing US authorities' concerns that the auditor-client relationship may be compromised through provision of consulting services;
- an assumption that financial statements are an instrument in investors' decisions;
- financial analysts are used as participants instead of loan officers; and

- used a control group where no consulting services were provided to avoid the SEC concern where immaterial auditor and client relationships may compromise auditor independence.

Findings show that immaterial relationships between auditors and clients (prime or sub-contractor, or joint venture) do not affect financial analysts' perceptions of auditor independence, financial statement reliability, and investment decisions. However, the existence of material relationships does affect financial analysts’ perceptions, thus financial interests between the parties are perceived to compromise auditor independence. Further, financial analysts preferred an internal separation between corporate divisions performing audits and NAS.

Management consultancy services (MCS) fees exceeding 50 per cent of the audit fee compromises auditor independence when MCS are provided (Teoh & Lim, 1996). The authors found that, after a client’s audit committee, MCS fees are the next priority in affecting auditor independence. Bartlett (1997) used a case where an audit firm embarked on due diligence on an acquisition for a client which they later audited. Auditors and bankers were the participants of this study. Findings show that whilst bankers considered the auditors compromised, auditors did not agree.

In a UK study, auditors, finance directors, and finance journalists ranked three NAS fees to audit fees’ percentages (25%, 50%, and 100%) in the matter of compromising auditor independence (Beattie, Fearnley, & Brandt, 1998). Finance journalists ranked the 100 per cent level of NAS as the second-threat factor and finance directors ranked it as the sixth. At the level of 50 per cent of audit fees, the ranks were fifth and tenth for finance journalists and finance directors, respectively. At the level of 25 per cent, the ranks dropped to fourteenth and eighteenth, which mean that high levels of NAS fees increase economic dependence and may compromise auditor independence.

Financial statement users’ opinions regarding auditor independence when an audit firm provides both internal and external audit functions to a client were the subject of a study by Swanger and Chewning (2001). Internal audits can be performed under various arrangements, including outsourcing to the current auditor, outsourcing with separation of internal and external personnel, outsourcing to another audit firm, and outsourcing only a part of the internal audit function. Authors argue that when auditors deliver internal audit services for their clients, the economic bond becomes greater, which may risk auditor independence. Findings indicate that analysts’ preferred the internal audit function to be performed by the company's employees or outsourced to an audit firm other than the company's external auditor. Study participants also preferred the safeguard of staff separation. These results indicate that outsourcing internal audit per se is not problematic; rather, outsourcing internal audit services without applying safeguards lowers perceptions of auditor independence. Consistent findings were reported in Lowe, Geiger and Pany (1999) who found that the provision of internal audit services to audit clients affects the users' perceptions of auditor independence; however, this effect could be minimised by the separation of internal and external staff personnel within the audit firm, as reported in many previous studies. This result indicates that applying appropriate safeguards has a major role in maintaining auditor independence.

4.3.2 Archival Studies

United States studies using the archival method began in the early 1980s in response to the US Securities and Exchange Commission (US SEC) Accounting Series Release (ASR) No.250[17] (1978) that required the disclosure of audit and non-audit fees. However, after the US SEC rescinded this requirement in 1982 (Dennis, 2000), most studies investigating the issue of NAS and auditor independence used surveys. The archival method re-emerged earlier this decade when the US SEC revised its auditor independence rules requiring the disclosure of audit and non-audit fees (US SEC 2000).

Authors of various studies on the relationship between NAS provision and earnings management argued that certain non-audit services might impact auditor independence, which may affect earnings quality. However, the joint provision of audit and non-audit services may be more efficient (Simunic, 1984; Palmrose, 1986). A number of other studies on this issue (Frankel et al., 2002; Dee, Lulseged & Nowlin, 2002; Ashbaugh, LaFond & Mayhew, 2003) produced findings that the provision of NAS does not appear to compromise auditor independence. Therefore, a minimum number of researchers reported a negative relationship between NAS and earnings quality, whilst most authors do not find any relationship.

In the US, Frankel et al (2002) investigated the relationship between auditor fees and earnings management. They found a positive relationship between the purchase of NAS and reporting a small increase in earnings surprise, that is, when a company's earnings report

[17] ASR No. 250 requires public companies to disclose data in their proxy statements including: first, both the percentage of NAS fees to audit fees and the percentage of each non-audit service fee to audit fee if the percentage of this non-audit service exceeded 3% of audit fee; Second, whether the board of directors or its audit committee approved this NAS. This rule was effective September 30, 1978 and remained until February 1982.

either exceeds or fails to meet analysts' estimates. The researchers also investigated any relationship between non-audit fees and share price movements on the date of fee disclosure. They found a negative relationship between non-audit fees and the share price. These results indicate that investors interpret NAS as evidence of auditor independence impairment because clients pay high non-audit fees relative to total fees. However, these findings were inconsistent with those of Ashbaugh et al (2003). They replicated the Frankel et al (2002) study and found no association between disclosing higher than expected NAS fees and the share price, arguing that the Frankel et al. results are sensitive to research design. Ashbaugh et al. state that using the ratio of NAS fees to total fees does not capture the economic importance of the client to the audit firm, especially when the total fees of a client are immaterial to the audit firm. Thus they claim that using total audit and non-audit fees, instead of the percentage or ratio of non-audit fee to total fee, is a more appropriate measure of the economic importance of an individual client to the audit firm.

The link between earnings management and NAS was examined by Dee et al. (2002), who sampled the top 500 US firms to avoid immateriality of the total client fees to the audit firm; variations in the non-audit fee to total fee ratio, as a measure of economic importance, are therefore driven through the NAS fees. Findings indicate that clients paying high relative amounts of NAS fees to their auditors have income-increasing discretionary and total accruals, thus auditor independence is compromised. Another line of relationship research compares NAS, audit opinion decisions and audit failures, where authors examine cases of declared audit failure to establish the influence of NAS on the failure. This research is inconclusive, with both a no relationship hypothesis and a positive relationship reported. In the US, Kinney, Palmrose, and Scholz (2004) investigated the association between non-audit fees and reissued financial statements (restatements). Findings indicate a positive relationship between audit-related services and unspecified non-audit fees and restatements, suggesting economic dependence. Other NAS, provision of financial information systems or internal audit services, had no relationship with the restatements.

Few Australian studies on the theme exist. Wines (1994) reviewed financial statements from 76 companies to determine any relationship between the audit reports and the proportion of non-audit fees, finding that auditors are less likely to qualify their opinions when receiving higher non-audit fees. This suggests that the provision of NAS may compromise the actual auditor independence. Similarly, Sharma and Sidu (2001) studied 49 Australian companies in receivership, using the ratio of non-audit fees to total fees as a measure of the economic bond.

Findings of this study indicate that auditors have less reservations regarding the propriety of clients paying high proportions of non-audit fees to total fees, which supports the impairment argument.

The relationship between non-audit fees and audit fees is the subject of many studies suggesting that a negative relationship between these fees compromises independence, as auditors tend to reduce audit fees to generate high non-audit fees (Simunic, 1984; Palmrose, 1986; Barkess & Simnett, 1994; Ezzamel, Gwilliam, & Holland, 1996, & 2002; Firth, 1997a; Craswell & Francis, 1999). Further, provision of audit and NAS is found to be cost-efficient (Abdel-khalik, 1990; Whisenant, Sankaraguruswamy, & Raghunandan, 2003). Cost efficiency can be divided into two types, *knowledge spillovers* and *contractual economies of scope* (Simunic, 1984). The former arises when audit and NAS, provided simultaneously to a client, require the same data and expertise for both service types. Cost savings for the provider then create incentives perceived to impair auditor independence. The latter type, contractual economies of scope, arises when one contract with one firm for both audit and NAS obviates the cost of seeking professional services from two or more providers (Simunic, 1984). These efficiencies can thus produce savings for auditors, which may increase the economic-based risk to auditor independence through increased bonding with the client firm.

Findings of a positive relationship between non-audit and audit fees paid to the current auditor (Simunic, 1984; Palmrose, 1986; Barkess & Simnett, 1994; Ezzamel et al., 1996 & 2002; Firth, 1997a; Craswell & Francis, 1999) are offset by other findings of either no relationship, or a negative relationship (Abdel-khalik, 1990; Whisenant et al., 2003). Arguments for a positive relationship between NAS and audit fees include a firm's increased audit and NAS needs, or further NAS requirements (Simunic, 1984; Palmrose, 1986). A contemporary small NAS market and thus competition among clients for NAS from the large audit firms was argued by Solomon (1990), who further theorised that auditors may misclassify NAS fees within the audit fee. These inferences have not been empirically tested.

As noted above, Firth (1997a) found a positive relationship between audit and NAS; this study concerned firms on the Oslo Stock Exchange. In a UK study, Firth (1997b), argued that companies with high agency costs (remuneration of organisation's members) purchase less NAS from their auditors. This means that a lack of perceived auditor independence would likely increase the cost of capital, which is suggested by the agency theory. Firth explained that such companies consider independent audits vital to reassure investors and creditors. The findings of this study indicate positive relationships between the variables of interest, levels of director, senior executive shareholdings, and stock ownership by a single investor and the level of NAS purchased from the current auditor. There was a negative relationship between debt-equity ratios and the level of NAS purchased from the current auditor. These findings indicate that the provision of NAS by incumbent auditors may impair auditor independence in appearance if the audit client is facing high agency costs. Firth (2002), following Simunic (1984) and Palmrose (1986), also argued that the positive relationship between audit and non-audit fees could be related to client-specific events requiring additional auditing. In his study, where he controlled for client size and events such as mergers and acquisitions, new accounting systems, and restructuring, no evidence of a positive relationship occurred. However, testing the relationship between audit fees and clean audit opinions, the research findings were that high non-audit fees are associated with clean audit opinions. Possible interpretations for this outcome are that the provision of NAS may remove uncertainties and disagreements prior to the audit, and second, the provision of NAS may be impairing auditor independence.

A recent New Zealand study by Hay, Knechel and Li (2006) on the impact of NAS on auditor independence examined the relationship between audit fees and non-audit fees; between non-audit fees and the audit report; and last, between non-audit fees and stability of audit tenure. Findings indicate a significant positive relationship between non-audit and audit fees, which implies a lack of auditor independence in appearance based on the economic dependence argument. The other two tests do not show a relationship between NAS and audit opinion, and stability of audit tenure.

4.4 Studies Signifying a Positive Effect on Auditor Independence

A number of studies found that providing NAS to the audit client does not compromise auditor independence (Goldmand & Barlev, 1974; DeAngelo, 1981b; Wallman, 1996; Arruñada, 1999b). Goldman and Barlev (1974) claim that, as consulting services are generally non-routine and benefit the client, replacing an auditor may result in the client losing valuable advice; therefore auditor independence is enhanced. DeAngelo (1981b) argued that large audit firms have more incentive to provide a high level of audit quality to their audit client, as the repeat audits and NAS provision increases audit quality to retain the client and enhance auditor reputation. Wallman (1996) proposes that the benefits of NAS to the audit client are in the public interest, as the auditor learns more about the audit client. Further, Wallman (1996) argues that the focus is whether the provision of certain types of NAS creates a relationship that causes material dependency on that client. Thus auditors can provide NAS to their audit clients without compromising independence, whilst furthering the public interest by enhancing auditors' understanding of their clients and the public's understanding of the auditor independence issue.

Few authors empirically report positive effects of NAS on auditor independence; thus providing higher quality audits (Lowe et al, 1999; Canning & Gwilliam, 1999; Jenkins & Krawczyk, 2002). Lowe et al (1999) find that loan-officer participants' confidence in auditor independence and loan approval rates increase when companies outsource internal audit services to the external auditor, but only when there is a separation between personnel within the audit firm. This result implies that providing internal audit to the audit client per se does not affect auditor independence. Canning and Gwilliam (1999) investigated the joint provision of audit and NAS in Ireland, applying survey and semi-structured interview methods with mixed results. Findings from the questionnaire survey of loan officers, investment managers, and financial analysts showed that auditor independence was compromised by NAS; on the contrary, findings from the interviews indicate that audit firms can increase their client knowledge through NAS, gaining a higher audit standard and a better audit opinion; however, such services have to be provided by separate personnel. Jenkins and Krawczyk (2002), using investors and professionals from audit firms as participants, report a positive relationship between auditor independence and the provision of NAS. They introduce two different cases to the participants: first, a case where an auditor provides only audit services to a client; and second, a case where an auditor provides audit and NAS. Findings indicate that users of the financial statements rely more on the auditors' opinions when NAS were provided to the audit client. Differences across investors and professionals were found showing that large firm auditors have higher positive perceptions than both other auditors and investors. This result shows that large firm auditors have different perceptions of auditor independence; however, this might be driven by the increasing revenue derived from the provision of NAS.

4.5 Studies Signifying No Effect on Auditor Independence

A number of authors reported that the joint provision of audit and NAS does not affect the perception of auditor independence. Those authors applied different research methods and studies were undertaken under different regulatory environments, which impact findings

(McKinley et al., 1985; Barkess & Simnett, 1994; Pringle & Bushman, 1996; Hussey, 1999; DeFond et al., 2002).

4.5.1 Survey Studies

It is important that auditors appear independent to the financial statements' users. Titard (1971) examined the provision of MAS on the appearance of auditor independence. Participants were asked whether the provision of certain types of MAS *may result in CPA's losing some of his audit independence* (ibid, p.49). Findings show that 51 per cent of respondents had no concern about auditor independence being impaired with the provision of MAS; whilst five types of MAS were deemed by a minority to impact auditor independence (mergers and acquisitions 32%; executive recruitment 27%; policy determination 27%; personnel appraisal and/or selection 23%; and executive and wage incentive plans 21%). A study by Reckers and Stagliano (1981) on NAS provision to audit clients used US SEC case study examples based on percentages of non-audit fees to audit fees. Participants, certified financial analysts and MBA students, expressed confidence of auditor independence for fees above 32 per cent of the audit fee, which was then the average level of NAS acquired by the case study companies.

The effects of MAS, audit firm size, and client office size on users' perceptions of financial statement reliability and auditor independence were the subjects of a study by McKinley et al. (1985). The participants, loan officers, were asked to indicate their level of confidence in the reliability of financial statements and whether to accept or reject a loan based on those statements. The findings show that the provision of MAS did not affect the financial statement reliability or the loan decision, thus auditor independence was not affected. Corless and Parker (1987) examined auditors' behaviour as participants in an experiment where they were asked to evaluate an audit client's internal control system. There were two groups of participants: the first group was told that their own audit firm had helped design the client's internal control system; and the second group was told that some other audit firm had helped design that system. Findings show that the variables did not impact the auditors' responses; however, auditors who were told their own firms had helped design the internal control of their clients were more critical of the system.

A UK study into the issue of auditor independence concerned finance directors' perceptions of the relationship between the audit clients' directors and their auditors, termed the *familiarity threat* (Hussey 1999). Familiarity threat to auditor independence is affected by factors such as the appointment method, the frequency of contact between the finance director and the audit partner, and the nature of the relationship. Participants also responded on the provision of NAS to audit clients. Whilst reporting a potential familiarity issue due to the involvement of directors at the selection and appointment stage, the majority of participants agreed that NAS does not affect auditor independence.

4.5.2 Archival Studies

Several studies using extant documentation to investigate the provision of NAS on auditor independence came to the conclusion that NAS have no effect on auditor independence (Barkess & Simnett, 1994; Pringle & Bushman, 1996; DeFond et al., 2002; Whisenant et al., 2003). Different approaches were used in the studies, such as the association between non-audit fee and audit fee, NAS, and audit opinion decisions and earnings management.

An early US study on NAS impact on auditor independence using archival data is that of Glezen and Millar (1985), who compared shareholders' approval of auditors before and after SEC ASR No. 250 was issued. They found no significant relationship between shareholder approval percentages and the amount of NAS between the three pre-disclosure years (1976-1978) and the post-disclosure year (1979). Their results are not clear: either shareholders do not consider NAS provision impacts auditor independence, or auditor independence is not important to shareholders. In Australia, Barkess and Simnett (1994) compared provision of NAS and type of audit report, found no relationship between NAS levels and the audit report issued, thus auditor independence was not compromised. In addition, they found a positive relationship between audit fees and non-audit fees but did not conclude impairment of auditor independence.

The relationship between the provision of NAS and the type of audit opinion issued to a limited set of data from 47 US public companies that declared bankruptcy (Pringle & Bushman, 1996) focused on auditor independence-in-fact. They argue that the issue of unqualified reports to failed companies provides indirect evidence of potential auditor bias, which can be used as a measure of independence-in-fact. They differentiate between failed companies receiving unqualified reports prior to failure, and those receiving qualified reports. They argue that companies receiving unqualified reports would purchase more NAS from their auditors than those receiving qualified reports. Findings show no relationship between the provision of NAS and the type of audit opinion issued, therefore NAS provision to audit clients does not affect auditor independence-in-fact. Craswell (1999) investigated the same issue using a larger Australian data set. Similar findings were reported, that the provision of NAS to the audit client does not affect auditors' decisions to issue a qualified opinion.

US auditors' tendency to issue going concern opinions was used as a surrogate for auditor independence by DeFond et al. (2002), who studied the association between non-audit fees and going concern opinions. Findings indicate no association between the percentages of non-audit fees to audit fees and reporting decisions, thus auditor independence is not compromised. For auditors, the cost of losing fees from large clients is lower than the cost of losing reputation and the cost of legal action. Geiger and Rama (2003) examined this issue, controlling for some factors, such as financial variables, management plans and mitigating factors, and audit committee type. They report the same results as DeFond et al. (2002) with the observation that market-based incentives are strong factors in auditors' reporting decisions, despite NAS fees. Studies on other variables on this theme, such as audit pricing, conclude that qualified audit opinions require additional work and that the increase in audit fees is justified. In confirmation of extra audit fees, Bajaj, Gunny, and Sarin (2003) studied auditor fees from audit and NAS, and audit failure. They found that NAS fees are higher in cases of severe audit failure, and such companies require additional audit work.

Archival studies in the US proliferated upon release of audit fee data in 2001. A focus on the relationship between NAS and earnings management resulted in the majority of authors reporting no evidence of impaired auditor independence (Chung & Kallapur, 2003; Ashbaugh et al, 2003; Ruddock et al, 2006). Chung and Kallapur (2003) studied the association between client importance measures and abnormal accruals, using the ratio of non-audit fees from a client to the audit firm's total revenue, and total fees (audit and non-audit fees) from the client in relation to the audit firm's total revenue to measure client importance. After controlling for other variables that influence abnormal accruals such as industry, and determinants of abnormal accruals, their findings show no evidence of an association between unexpected accruals and either a ratio of audit fees to NAS, or ratios measuring the importance of the client's non-audit fees to the audit firm's total revenue.

Using Australian Stock Exchange data, Ruddock et al. (2006) studied the association between the provision of NAS and the extent to which earnings reflect bad news on a timely basis (that is, news-based conservatism). They assume that the reputation factor of the larger audit firms, as suggested by DeAngelo (1981b), safeguards and encourages conservative financial reporting more so than smaller audit firms. Findings show the assumption is correct, larger audit firms are associated with more conservative auditing; also, NAS provision does not impact such conservatism. These findings confirm that NAS purchases by the audit client do not impair auditor independence.

4.6 Studies Investigating Types of Threats to Auditor Independence

There are a number of key risks to auditor independence in the literature. NAS provision to the audit client can contain a real or perceived threat, including: self-interest; self-review; advocacy; and familiarity. Auditors need to be aware of any situation where professional objectivity may be compromised, therefore these types of threats are discussed and related empirical studies presented in the following four sub-sections.

4.6.1 Self-interest Threats

Self-interest threats occur when auditors act in their own interest in preference to performing a quality audit (International Standards Board [ISB], 2000). Self-interest can be financial, emotional, or any type of personal interest. The International Federation of Accountants (IFAC) identifies circumstances under which self-interest situations occur (IFAC handbook, 2006, p.43)

- a direct financial interest or material indirect financial interest in an assurance client
- a loan or guarantee to or from an assurance client or any of its directors or officers
- undue dependence on total fees from an assurance client
- concern about the possibility of losing the engagement
- having a close business relationship with an assurance client
- potential employment with an assurance client
- contingent fees relating to assurance engagements.

These circumstances relate to NAS and other types of relationship between auditors and their clients where auditor independence may be compromised by the self-interest threat.

Self-interest situations are the subject of the majority of research investigating auditor independence impairment. For instance, Knapp (1985) found NAS a factor in independence impairment; however, it was not the major variable. As self-interest situations between auditors and their clients, joint venture arrangements were found by Bartlett (1993) to reduce severely auditor independence. In addition, Lowe and Pany (1995) find consistent results when examining different types of business relationships, i.e., prime contractor, sub-contractor, and a joint venture arrangement.

In the UK, Beattie et al. (1998) examined factors believed to undermine auditor independence, finding that when an audit partner's income depends on the retention of a specific audit client, auditor independence is severely compromised. Findings show that when NAS fees equal those of the audit, NAS is ranked second in factors undermining auditor independence, whilst the third ranking was the partners' fear of losing a key client. These factors refer to financial interest, a major self-interest threat to auditor independence.

Economic bonding increases between auditors and their clients when the level of NAS purchased increases, thus risking auditor independence to ensure continued tenure. Auditor tenure and the level of NAS in an Australian study by Barkess and Simnett (1994) were found to have no impact on auditor independence.

The theme of many studies is the influence on auditors' reporting opinion created by its financial interest in NAS (Wines, 1994; Craswell, 1999; Sharma & Sidhu, 2001; Hay et al., 2006). Wines' (1994) study concerned the effect of higher levels of NAS and the instances of a qualified audit opinion, finding that auditors are less likely to give a qualified opinion when there are higher levels of non-audit fees. These results suggest that, due to economic dependence, auditor independence is compromised. In New Zealand, Hay et al. (2006) tested for a relationship between non-audit fees and audit report qualifications, and between non-audit fees and audit tenure for three years. Their findings show a significant positive relationship between non-audit fees and audit report qualification in only one of the three years; however, no relationship was found between non-audit fees and audit tenure. These results suggest that, when auditors provide NAS for audit clients, independence of mind should not be affected. However, the high levels of NAS fees paid to auditors may provide some evidence that the perceived auditor independence is impaired.

A self-interest threat is raised by economic bonding between the auditor and the client brought about by the relationship between NAS provision and earnings management. The increase of economic bonding through NAS may risk auditor independence and reduce the quality of audit. Research on this issue yields mixed results: a positive relationship between a client paying high NAS fees and discretionary income increasing (Dee et al., 2002; Frankel et al., 2002), thus auditors receiving high non-audit fees have less control over earnings management; other authors do not find any relationship (Francis & Ke, 2003; Ashbaugh et al., 2003; Ruddock et al., 2006). The mixed results derive from proxies, variables used, and research design (Ashbaugh et al., 2003).

4.6.2 Self-review Threats

The Conceptual Framework for auditor independence (ISB 2000, para.12b) illustrates and defines the self-review threat as follows

> It may be more difficult to evaluate without bias one's own work, or that of one's firm, than the work of someone else or of some other firm. Therefore, a self-review threat may arise when auditors review judgments and decisions they, or others in their firms, have made.

In the US, the *Sarbanes-Oxley Act 2002* prohibits auditors providing a number of NAS to their audit clients who are SEC registrants, including appraisal, valuation, internal audit, bookkeeping, and actuarial services. Auditors may provide other NAS, such as tax services, if the company's audit committee approves them in advance. The provision of bookkeeping services for the audit client impairs auditor independence. This rule is adopted by many accounting organisations, such as Institute of Chartered Accountants in England and Wales (ICAEW); Institute of Chartered Accountants of Scotland (ICAS); and American Institute of Certified Public Accountants (AICPA); to strengthen assessment of accounting policies on resource allocations and transactions, and protective and internal controls (Porter et al., 1996). Lavin (1976) in the USA and Dykxhoorn and Sinning (1981) in Germany investigated the perceptions of auditors and users of financial statements (bankers and brokers) in three auditor-client situations concerning the provision of bookkeeping services. These services are: first, the auditor maintains the journals and ledgers, makes adjustment entries and prepares financial statements; second, the auditor maintains only selected general ledger accounts in a private ledger; and third, the auditor only receives the original entires printed on tapes and sends them to a third party to print out the general ledgers and financial statements before sending them back to the client without editing. Dykxhoorn and Sinning (1981) found that auditors only perceived the first situation as impairing auditor independence in both countries, while in the prior study, users of the financial statements perceive all three situations as not impairing auditor independence (Lavin 1976). Using bankers in the UK, Firth (1981) examined the situation where the auditor maintains the journals and ledgers, makes adjustment entries and prepares financial statements, finding that participants regarded this situation as reducing their confidence in granting a loan. This overview concluded that perceptions of the self-review threat to auditor independence vary between countries.

Both Shockley (1981) and the Public Oversight Board (1979) are concerned with providing system design, that is, internal control systems, to an audit client, as auditors are perceived as reviewing their own work. Tax preparation and acquisition review are considered lesser risks to auditor independence. For instance, Pany and Reckers (1983) asked directors whether auditors can remain independent if contracted to perform systems design, tax preparation, and acquisition review. Findings show that although systems design was considered as a less routine service than the tax preparation and acquisition review services; participants believe that it causes a greater self-review threat to auditor independence. This result is contrary to Goldman and Barlev (1974), who stated that the provision of less routine NAS strengthens auditor independence, as the auditor’s value to the audit client increases.

Design and implementation of accounting systems and assistance in accounting for complex transactions were examined by Bartlett (1993), finding neither compromise auditor independence. Other NAS routinely provided as part of the audit may cause the self-review threat to auditor independence, for example, adjustment entries recommendations; involvement in the preparation of income tax provisions; and determination of allowances for doubtful accounts, notes receivable, and other accounts that may require special judgment. As auditors are experienced and cost-effective providers of NAS, obviating the self-review threat by not providing such services is deemed impractical; however, this view is weakened as the NAS fees become a higher proportion of the overall audit and NAS fees.

4.6.3 Advocacy Threats

Advocacy threat arises *from auditors or others in their audit firm promoting or advocating for or against an auditee's position or opinion rather than serving as unbiased attestor of the auditees' financial information* (ISB, 2000, para.12c). Auditors, as client advocates when providing certain types of NAS, find difficulty with third party perception of auditor independence. Others consider that, because auditors only provide advisory services, they are not involved in the client’s decision-making processes and their independence is not compromised.

These two views regarding advocacy threats are the main arguments in the literature. The provision of NAS to the audit client may create conflict of interest between the stakeholders: the auditor, the client, and users of the financial statements. Advocacy risk rises if an auditor is promoting a client's securities, acting as a client advocate in litigation, or involved in client decision-making processes (IFAC, 2006). Few authors have discussed these issues (Carey & Doherty, 1966; Kell, 1968; Brody & Masselli, 1996; Dunn, 1996). The provision of tax services for audit clients may cause a threat to auditor independence. For instance, Brody and Masselli (1996) argue that auditors often act for the benefit of their clients, especially in situations where the law is ambiguous, which may reduce auditors' objectivity. Moreover, auditors may provide more services to increase the economic interest in a larger client, whilst the loss of NAS fees may thereby impair auditor independence. On the other hand, many authors believe that auditor independence can be maintained (Carey & Doherty, 1966; Kell, 1968). For example, Kell (1968) argues that tax service is part of the accounting and auditing services provided by the auditor, thus the public does not perceive tax service as impairing auditor independence. Further, auditors are expected to provide advice on tax planning and preparation, and do not participate in decision-making. An empirical study of tax service provision by Reckers and Stagliano (1981) found that financial analysts and MBA students were not concerned about auditor independence, whilst Dunn (1996) takes this further by arguing that the knowledge gained from the audit and tax planning could be used to plan a more effective audit.

In Saudi Arabia, the Saudi Organization for Certified Public Accountants (SOCPA) does not prohibit the provision of tax service to audit clients. Hudaib (2003) interviewed a number of Saudi stakeholders to investigate the effect of the provision of tax and zakat services on auditor independence. Findings indicate that the majority of auditors, and all shareholders and credit managers perceived the provision of tax service as a threat to auditor independence, while investment analysts and government representatives did not. Hudaib (2003) attributed this view to the role of Saudi auditors in providing tax service includes both preparation of the accounts and the defence of the client's tax and zakat liabilities to the Department of Income Tax and zakat (DITZ). In the Saudi case, there is a perception of risk to auditor independence due to auditors advocating their clients' position.

The effect of NAS provision on auditor independence for both financial system design and implementation, and internal audit was investigated by Kinney et al. (2004) who were examining the probability of restatement of audited or reviewed financial statements. These two NAS activities could impact auditor independence, assuming that auditors are involved in the decision-making process. Findings indicate that fees from providing these forms of NAS increase the probability of restatement of audited financial statements; as such adjustments reflect low quality financial reporting.

4.6.4 Familiarity Threats

The familiarity threat arises when an auditor is not sufficiently removed from the client's affirmations and is influenced by the executive (ISB, 2000; ICAEW, 1997). This occurs when an auditor has a particularly close or long-standing relationship with a client: its directors, officers or employees. The circumstances that may create a familiarity threat to auditor independence reported in the IFAC handbook (2006, p. 44) include

- a member of the assurance team having an immediate family member or close family member who is a director or officer of the assurance client
- a member of the assurance team having an immediate family member or close family member who, as an employee of the assurance client, is in a position to exert direct and significant influence over the subject matter of the assurance engagement
- a former partner of the firm being a director, officer of the assurance client or an employee in a position to exert direct and significant influence over the subject matter or the assurance engagement
- long association of a senior member of the assurance team with the assurance client
- acceptance of gifts or hospitality, unless the value is clearly insignificant, from the assurance client, its directors, officers or employees.

In a study of advocacy and self-interest threats to auditor independence, Schulte (1965) examined the type of relationships clients have with their auditors: professional friendship, acquaintance, and personal relationship. Through inferences from the study's findings, such a relationship may cause a familiarity threat as well. Using UK finance directors as study participants, Hussey (1999) investigated the nature of the relationship between the auditor and board directors and the effect upon auditor independence through the method of appointment or the selection criteria for auditors; duration and frequency of contacts between finance directors and auditors; and the finance directors' perceptions of the nature of their relationships with auditors. These factors are not related to NAS; however, there may be an indirect relationship, for example, the appointment process may consider the auditor's ability to provide NAS. Findings were that, although a familiarity threat can be created, its influence may be exaggerated, particularly in respect to the provision of NAS. This is illustrated by Hussey's study participants reporting that a personal relationship with the auditor is the most desirable characteristic in the selection process. One third of respondents reported the duration of a current auditor and client relationship as more than 15 years, thus a long relationship may strengthen the relationship. Further, respondents stated that auditor and client relationships were professional and amicable and this was not affected by their opinions on NAS. However, these results can be interpreted as impacting auditor independence.

A NAS provided by an auditor to a client is the recruitment of the chief finance officer (CFO), which may create a threat to auditor independence by increasing the depth of the relationship and thus a risk of familiarity because auditors may rely on the CFO's opinion and not their own investigations. Bartlett (1993) investigated the issue of executive recruitment without significant result. However, Pany and Reckers (1984) investigated the executive search factor and reported that providing recruitment services to audit clients does not affect the independence of the external auditor.

4.7 Limitations and Summary

There are three possible findings to all studies that investigate the effect of the provision of NAS to the audit client on auditor independence as follows

- negative effect, or impairing auditor independence
- positive effect, enhancing auditor independence
- no effect, that is, providing NAS does not affect auditor independence.

Researchers applied a number of methods and models to study the effect of the joint provision of audit and NAS on auditor independence. For instance, they use questionnaire methods to investigate the financial statement users' perceptions of auditor independence; and archival methods to investigate the auditor independence-in-fact by applying a variety of models that use different proxies for auditor independence such as earnings management and audit opinions.

A number of limitations of the previous studies was identified. First, authors who investigated the users' perceptions of auditor independence placed more emphasis on audit firms that are financially dependent on the audit client, thereby causing the self-interest threat. Few researchers attempted to investigate other threats: self-review, advocacy, and familiarity. Second, the internal validity of the questionnaires used to collect data from the participants is open to doubt, as seen in some studies that experienced the risks of demand effects. Third, it is difficult to compare the results of studies performed in different countries, as economic and regulatory environments vary between countries and over time. Fourth, early studies reported findings showing negative effects of the joint provision of audit and NAS on auditor independence, whereas, after recognising potential advantages, several recent studies reported positive impacts of the joint provision on auditor independence.

Studies using the archival method also have some limitations. As mentioned above, there are different lines of research that use publicly available data to investigate the issue of the joint provision and auditor independence. Each line of research uses a specific measure for auditor independence, such as audit pricing and audit tenure, audit opinions, and earnings management and audit quality. Each incorporates a number of limitations.

First, the interaction between audit and NAS makes it difficult to generate clear evidence regarding economies of scope, which is believed to affect audit pricing. Second, the quality of the publicly available data is always questionable because early studies used data collected using the survey method which may involve a possible response bias; and the most recent studies used publicly available data, however, these data come in an aggregate form which makes it difficult to know the exact cost of each type of NAS provided to the audit client (Palmrose & Saul, 2001).

Authors who investigated the linkage between the joint provision, audit opinion, and earnings management reported mixed results. Some limitations can be observed such as that audit opinion and earnings management models need to be valid and sufficiently precise to reflect all variables that affect the audit decision. Thus, although some authors reported evidence showing the relationship between the joint provision and the proxies used to measure auditor independence, it is unlikely to be interpreted as affecting auditor independence.

These chapters, (three and four) focus on the literature review of auditor independence regulatory frameworks, and empirical studies investigating the effect of the provision of NAS on auditor independence, respectively. The next chapter discusses the research conceptual framework of the current study. The auditor independence framework developed by the Independence Standard Board (ISB) is applied and discussed in detail.

Chapter 5 Research Conceptual Framework

5.1 Introduction

The literature on auditor independence reviewed in the preceding two chapters concerns theory development on the phenomenon, framework methodologies, and empirical studies regarding the effect of audit and non-audit services (NAS) on auditor independence. To form this study's structure upon this evidence, a conceptual framework is presented in this chapter.

A research conceptual framework is the basic structure on which a study is built and, inter alia, it provides the grounds for research (Bell, 2005). The framework also facilitates understanding of the study's findings for practitioners and researchers. Polit and Hungler (1995, p.101) state that:

> Frameworks are efficient mechanisms for drawing together and summarizing accumulated facts …The linkage of findings into a coherent structure makes the body of accumulated knowledge more accessible and, thus, more useful both to practitioners who seek to implement findings and to researchers who seek to extend the knowledge base.

In fact, the construct is the research study's frame of reference and it provides a satisfactory foundation on which the study stands. The framework supports the research problem, the questions arising from the problem, and thus leads to the formation of hypotheses.

The objective of this study is to investigate stakeholders' perceptions of the effect of the joint provision of NAS and audits on the independence of the auditor provider in the Saudi auditing environment, where, apart from tax and zakat (tithes) services such provision is prohibited. The study's conceptual framework therefore provides the means to demonstrate the issues impacting auditor independence, as well as considering threat-mitigating safeguards in the case of audit firms providing NAS to their audit clients. The research framework of this study is based on the conceptual framework developed by the Independence Standards Board (ISB) (2000).

Investors, as the providers for the capital market, rely on audit reports when making their investment decisions (Maury, 2000). Auditors of the financial statements add value to those decisions through imparting credibility and integrity to financial statements and providing unbiased opinions of the financial position of public companies, thus providing some protection to the interests of the users of the financial statements (Johnston, Sutton & Warfield, 2001). Therefore, the external auditor plays a major role in providing independent credibility and integrity to the financial statements of companies to allow investors and other stakeholders to make rational decisions based on these audited financial statements. Consequently, auditors should be concerned about the users' perceptions of their independence when examining clients' financial statements, that is, the external auditors are compelled to be independent in both fact and appearance when providing audit to their audit clients (Fearnley & Beattie, 2004).

The importance of comprehensive and enforceable auditor independence standards is emphasised by significant corporate malfeasance in the past several years, for example, Enron in the USA and HIH in Australia. These corporate scandals exposed the issue of auditor independence where the external auditor provides both audit and NAS services for the same client, casting doubt over the independence of the external auditor and overall value of auditing. In these situations, the authorities and users of the audited financial statements question the role of auditor independence in confirming the quality of the relevant financial statements. The Technical Committee of the International Organisation of Securities Commissions (IOSCO) encourages its accounting and auditing members to assist regulators with a view to improving existing auditing standards, particularly for auditor independence (IOSCO, 2002). It is important to strengthen auditor independence to remove the perception or fact of bias regarding an audit of clients' finances and thus offering a degree of protection for investors. Further, high quality audits should enhance users' perception of the reliability of the financial reporting process, which, in turn, should facilitate optimal allocation of capital. To improve the perception of independence by reasonable investors, audit independence standards should be designed to support an environment where the auditor is free of any interest, relationship, or influence which could weaken professional judgment or objectivity. The standards should mitigate any threats to auditor independence.

This chapter delineates the study framework in three sections followed by a summary. The first section defines the nature of auditor independence; the second section discusses the study framework in more detail; and the third section presents the research questions.

5.2 Auditor Independence Framework

As mentioned above, the conceptual framework of this study is based on the ISB 2000, Statement of Independence Concepts, which requires the identification and evaluation of issues regarding independence and safeguards which may be employed to reduce adverse matters impacting independence to an acceptable level. This framework is crucial to developing principle-based independence standards. The ISB 2000 statement contains concepts of auditor independence and the basic principles to guide auditor independence standards.

The need for a well-defined audit independence framework for Saudi Arabia arises from the plethora of rules and regulations impacting audit independence, the majority in the form of interpretations and guidelines issued in response to specific independence questions over the years and under changing situations. These interpretations and guidelines are sometimes inconsistent and lack theoretical basis. Further, auditors are challenged in applying such guidelines if the nature of the audit and client relationship differs from that defined in the regulatory decision. The benefits of employing such a framework are emphasised by its adoption by the Institute of Chartered Accountants in England and Wales (ICAEW), Institute of Chartered Accountants in Australia (ICAA) and the International Federation of Accountants (IFAC).

The definition of auditor independence (ISB 2000) at s3.2.1 emphasises freedom from pressures that compromise an auditor's ability for unbiased decision-making, Nevertheless, auditors cannot be free from all pressures that may affect their decision-making ability; however, the ISB definition refers to major factors that could reasonably be expected to compromise the outcome of an audit. The ISB (2000) further describes a *reasonable expectation* as a rational belief of a well-informed investor or other users of financial information, thus calling into question a user's ability to judge whether an auditor's report is unbiased. Thus for auditors to be independent, they must be reasonably expected to overcome pressures leading to bias. Consequently, the focus of this framework is not on the audit environment in which impairment of auditor independence can occur, but on the auditor's ability to issue unbiased decisions. In other words, auditor independence does not stand upon regulation alone, the audit environment constrained by regulation is not sufficient for true independence. As a result, this study's framework does not provide rules or regulations to solve certain disputes related to auditor independence or give answers to exact independence questions, but it provides a structure and methodology for analysing issues related to auditor independence. The focus of this study is on issues arising from the provision of NAS by an auditor to an audit client.

In order to assess the independence of auditors, according the ISB 2000, decision-makers are required to consider the following:

- pressures and other factors that might weaken auditor independence and cause biased audit decisions
- controls (safeguards) that may eliminate or reduce the effect of those pressures
- significance of the pressures and the use of safeguards
- the possibility that, after considering safeguards, pressures may still cause impairment to auditor independence, that is, independence risk.

Consequently, the following steps are necessary to develop, implement and maintain auditor independence standards (ISB, 2000):

- identify and classify issues impacting auditor independence,
- identify and evaluate controls and safeguards that address those issues,
- determine an acceptable level of independence risk.

The goal of auditor independence, as stated in the ISB 2000, (para. 8), is *to support users' reliance on the financial reporting process and to enhance capital market efficiency.* This is a broad objective which encompasses the direct benefit of an unbiased audit decision, and indirectly serves the public interest by enhancing users' reliance on the financial statements, that is, investors, creditors, underwriters, financial advisors, businesses, and regulators. The ISB 2000 definition acknowledges that, due to the contractual nature of their relationship, auditors cannot be totally independent from their audit clients, for example, auditors receive a fee for their services. However, a commercial relationship is not an issue unless adverse factors are involved, that is, independence risk.

Another issue in auditor and client relationships is prior acquaintance, especially in smaller professional environments such as Saudi Arabia, where auditors are well known in the business environment (Hudaib, 2003). Although acquaintance can impact a relationship, the ISB 2000 goal states that auditors should be free from factors that may compromise unbiased decision-making, however, these factors are not identified. The ISB 2000 framework provides comprehensive guidelines so that an auditor can use a self-evaluation approach to assess a position and a client relationship, and decide whether a perception of impaired auditor independence could exist.

5.3 Study Framework

This study's research framework relates to issues regarding auditor independence when auditors also provide their audit clients with NAS. The relationships between audit firms and their clients when NAS are also provided are conceptualised in Figure 5.1, ISB 2000: Modified NAS and Auditor Independence Framework.

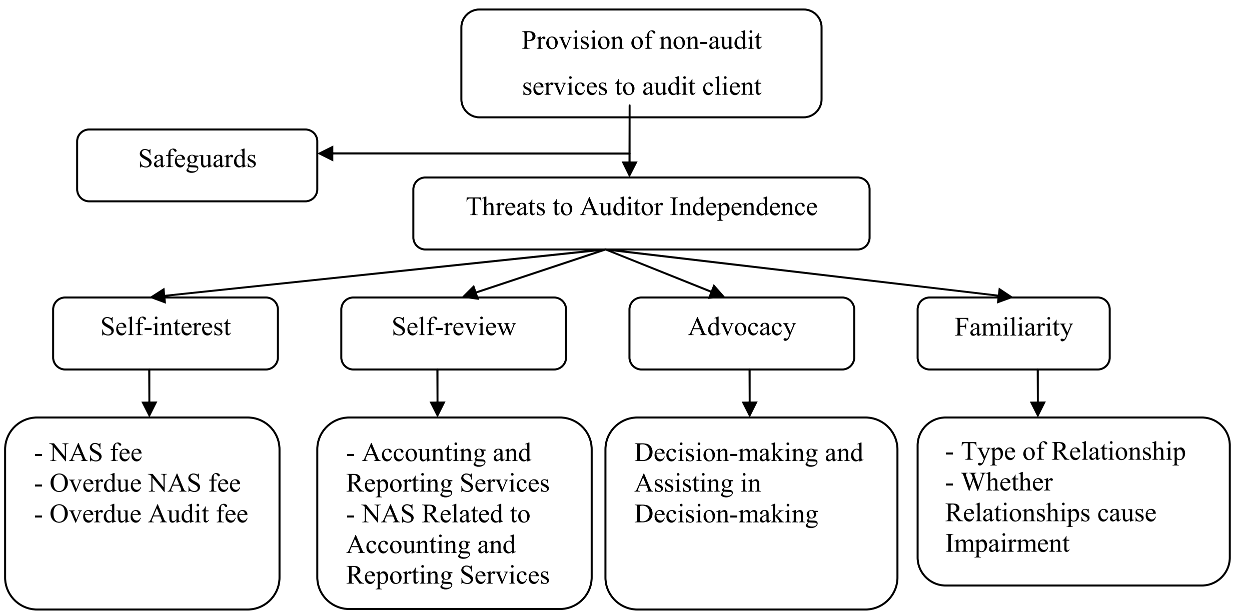

Figure 5.1 *ISB 2000: Modified NAS and Auditor Independence Framework*

Figure 5.1 shows an auditor and client relationship framework where causal factors, that is, the issues impacting independence (second level) are categorised by the nature of the issue (third level) and the relevant NAS area (fourth level). The framework allows a methodology based on a threat-safeguard approach for examining issues relating to auditor independence: as noted at s5.2: issues which may adversely impact auditor independence; safeguards to moderate or remove the matter; the interdependency and significance of these matters; and independence risk. These are discussed in turn.

5.3.1 Threats to Auditor Independence

The ISB 2000 framework for auditor independence identifies issues relating to the matter as pressures or other factors which can result in auditor bias. When auditors provide NAS to their audit clients, interests and relationships may arise that affect an auditor's objectivity and integrity, and his or her ability to issue an unbiased audit report. Two classes of independence were identified in the literature, independence-in-fact and independence-in-appearance (s.3.3.1; Magill, Previts, & Robinson, 1998). This framework covers the second type, independence-in-appearance, which takes into account the views of the users of the audited financial statements. This researcher considers that audit-profession regulators should identify factors that stakeholders consider may threaten auditor independence. ISB 2000 identifies five classes of threats to auditor independence including self-interest, self-review, advocacy, familiarity, and intimidation; of which the first four classes[18] are linked to NAS (Fearnley & Beattie, 2004). A brief review of these follows

<u>Self-Interest Threats</u> These are *threats that arise from auditors acting in their own interest* (ISB, 2000, para.12a). In general, self-interest threats are related to matters such as financial and emotional interests. In this study, the focus is financial interest, because auditors are financially dependent on their audit and other clients through the contractual relationship. However, several studies show that auditor independence is not affected by audit fees unless such fees represent a substantial portion of the auditor firm's total revenue (s4.6.1, Beattie, Brandt & Fearnley, 1999). It could be assumed, therefore, that further work by the auditor for a client through the provision of NAS and the resultant fees adds pressure on the auditor's independence. In addition, if an audit client is lost, there may be additional loss of NAS from that source. As a result, auditors may compromise their independence to keep their audit clients for the opportunity to provide further NAS.

<u>Self-Review Threats</u> This is an issue *that arise(s) from auditors reviewing their own work or the work done by others in their firm* (ISB, 2000, para 12b). Auditors may provide their clients with additional financial and accounting services such as bookkeeping, asset evaluation and financial statements preparation. Thus auditors could be placed in the position of assessing their own work, or the work done by their colleagues, *independently and without bias*. Past members of the client firm who now work for the auditor may be in a similar position of auditing their own work or the work of past colleagues. Thus, auditor

[18] Intimidation threat is the threat that arises from auditors' belief that they are being overtly or covertly coerced by clients or by other interested parties (ISB, 2000).

independence is perceived by stakeholders to be impaired as auditors are compromised by the proximity of the relationship. Some studies demur, suggesting that independence may not be threatened because auditors behave more independently and sometimes become more critical when a self-review threat is encountered (Dopuch & King, 1991; Davidson & Emby, 1996). Nevertheless, there is no evidence in the literature that self-review is advantageous in all cases.

Advocacy Threats *Threats that arise when an auditor acts as an advocate for or against an audit client's position or opinion rather than as an unbiased attestor* (ISB, 2000, para 12c). Auditors also provide their clients with NAS such as tax preparation, financial legal advice, underwriting and brokerage; however, auditor independence may be adversely affected through perceived conflict of interest. For instance, providing both audit and tax services to a client can result in the auditor supporting the client's position in a taxation inquiry, thus losing independence in the audit matter.

Familiarity (Trust) Threats *Threats that arise from auditors being influenced by a close relationship with an audit client* are defined as a familiarity issue (ISB, 2000, para.12d). Auditors and their clients undertake many different forms of relationship. In any relationship there is a risk that the auditor may be influenced by the client's business environment or the client's personality, or qualifications. The impact on auditor independence can occur when auditors are affected by such factors, adopting the financial views of that client through undue trust in that position, and thus becoming biased.

5.3.2 Safeguards to Auditor Independence

The ISB 2000 identifies safeguards to auditor independence as *all controls that mitigate or eliminate threats to auditor independence.* The standard framework requires all parties: the audit profession, clients and the statutory auditor organisations to implement safeguards to eliminate those threats or reduce them to an acceptable level. These safeguards are in place to ensure that auditors' decision-making ability regarding clients' financial statements is not unduly influenced from any source. In other words, auditors must take all required steps to ensure their independence, in fact and in appearance.

In its many classifications of safeguards to independence, the ISB 2000, the first to consider is the legal environment in which audits are performed, together with the policies of the auditing firm. Next, safeguards are classified by their nature: generally preventative or goal-based, related to a specific threat, and those designed to support the auditor independence system itself through punitive means. A third means by which safeguards are classified is the degree to which they restrict auditors' activities or relationships threatening auditor independence. This classification can prohibit all NAS relationships between the auditor and the audit client, place a limit on some activities or relationships, or limit NAS or relationships through safeguards to eliminate or mitigate matters impacting auditor independence. In summary, safeguards to auditor independence may be differently, based on the quality standards of the environment and the nature of the NAS under consideration.

In this study, the classification of safeguards adopted is that based on the environment of the contract. It follows that the forms of safeguards are legislative, the relevant auditing profession's standards, the auditing firm's policies and those of the audit client (Turner, Mock & Srivastava (2004). The following sections describe these classes of safeguards.

Regulatory and Professional Policies Jurisdictions and the audit professions in many countries issue regulations and principles which include auditor independence to protect the interests of users of audited reports. Auditor independence regulations and standards place restrictions on audit firms to eliminate or mitigate issues arising from NAS or the audit process. These safeguards include total or partial restrictions on NAS to the audit client, professional standards controlling auditor independence, educational and training requirements, and external review of an audit firm's quality controls if NAS is permitted.

Client Audit Policies Large audit clients frequently have policies regarding conduct of audits and NAS by an external auditor, as it is the clients' responsibility towards users of the audit report to ensure the independence of the external auditor. Policies of client organisations include auditor appointment by the board or persons other than management such as an audit committee on behalf of the shareholders and other stakeholders (Mayhew & Pike, 2004). For auditor appointments, at least one of the audit committee members must be appropriately qualified to assess whether auditor independence might be at risk, especially in the provision of NAS. Disclosure of the audit relationship in the audit report also enhances auditor independence.

Auditor Policies Audit teams and their firms must be independent to ensure that the audited financial statements fairly represent the financial position of their clients, and thus mitigate information risk (Monroe, 2002). Audit firms are also responsible for identifying and evaluating issues that may arise concerning the auditor and client relationship and take appropriate action to eliminate or reduce them to an acceptable level. When audit firms provide NAS, for example, conflict of interest issues can be addressed by the audit firm's quality assurance policies and quality control program to safeguard their independence. These policies and programs are emphasised through a director and executive mandate for auditor independence and that all audit team members will act independently. Larger audit firms can establish an independence board responsible for the firm's maintenance of auditor independence (Houghton & Jubb, 2002).

5.3.3 Independence Risk

The ISB 2000 (para.18) identifies independence risk as:

> the risk that threats to auditor independence, to the extent that they are not mitigated by safeguards, compromise, or can reasonably be expected to compromise, an auditor's ability to make unbiased audit decisions.

Thus, it is essential to assess the level of auditor independence risk by examining the classes of threats and safeguards affecting auditor independence, taking into consideration the views of stakeholders including auditors, clients, and users of financial statements. However, the ISB 2000 policy does not identify an acceptable level of independence risk.

5.3.4 Identifying and Addressing Issues

Threats to auditor independence become significant when they increase independence risk and safeguards become effective when they reduce independence risk (ISB 2000). The significance of threats is determined by a range of factors and relationships of auditors and their clients which must be identified and evaluated for severity to employ the appropriate action. It is essential to identify effective safeguards to eliminate or mitigate threats to auditor independence. Thus, the effectiveness of safeguards depends on design and application to address the issue.

5.4 Research Questions

This study investigates the perceptions of stakeholders' groups regarding issues relating to auditor independence and whether perceptions of the groups significantly differ on each issue. The research focuses on the stakeholders' assessments of the four classes of threat to identify the greater vulnerability to auditor independence in Saudi Arabia.

5.4.1 Perceptions of Auditor Independence

This study seeks Saudi stakeholders' perceptions of auditor independence if NAS are provided, investigating the effect of NAS on auditor independence and on audit quality; identifying factors to enhance independence, and threats to independence. The sample of finance-document stakeholders in this study consists of six groups including major firm auditors, minor firm auditors, loan officers, financial analysts, finance directors, and academics. Given the professional and market environment of each group, and the individuals' differences, the stakeholder groups' perceptions may vary markedly.

The expected variance is reflected in the literature. Research includes findings that provision of both audit and NAS to a client impairs auditor independence (e.g., Antle, 1984; Knapp, 1985; Wines, 1994; Gul & Tsui, 2003); and contrary results, that auditor independence is enhanced through NAS (e.g., Reckers & Stagliano 1981; Lowe, Geiger & Pany, 1999; Jenkins & Krawczyk, 2002). There is no consensus among researchers on the effect of NAS on auditor independence. Several researchers posit that auditors providing NAS compromise their independence in the conduct of their audits to avoid losing income (DeAngelo, 1981a; Antle, 1984; Matsumura et al, 1997). Further, many larger corporations pay their auditors significantly higher fees for NAS than for audit service (Read, 2001; Simunic, 1984). Providing NAS to a large audit client may therefore create a financial dependence which compromises an auditor's independence, depending on the provider's other income sources and the length of time the relationship endures. From the client's perspective, the provision of lucrative NAS contracts can increase the client's power over the auditor and impair auditor independence; in an earlier example, auditing firms discounted their audits to enhance NAS contracts from a target client (Mitchell, Sikka, Puxty & Willmott 1993). In addition, Jenkins and Krawczyk (2002) report that, at the time, the five largest global audit firms generated half their total revenue from NAS, whilst smaller audit corporations gained three-quarters of their income from auditing and the remainder from NAS.

Saudi Arabia's position on auditor independence differs from the experiences of developed economies. Although the Kingdom adopts international standards, and these govern its international financial practices, internally, traditional Shar'ia Law and civil law and regulations provide a less than certain environment for financial transactions, as both global and local firms operate within its jurisdiction (s.2.7.1). However, whilst the government is working toward addressing differences with international accounting and auditing standards[19], there is little information available on its progress toward compliance. For example, the government remains in control of accounting and auditing practices; thus a code of ethics similar to international accounting practice and a self-regulatory organisation for the profession were not adopted. SOCPA monitors adherence of auditors of listed companies to reporting and disclosure standards; however, it does not have the powers to enforce compliance and does not support a code of ethics. Given the existence of several authorities in charge of overseeing compliance with financial reporting requirements, Nadal and Saidi in a 2004 paper conclude that reforms are necessary to *avoid the regulatory loopholes created by the presence of several authorities* (p. 54). Further, there is inadequate accounting and auditing quality to meet the country's needs, and insufficient emphasis on the qualification standards for accountants (Al-Angari, 1999). Thus the international standards, placed within a Saudi context, may affect study participants' perceptions.

The objectives of finance directors and accounting managers who prepare financial statements may differ from the varying objectives of the statements' users (Lavin, 1976; Shin, 1994). In this situation, the auditors' role is to monitor and mitigate any bias in management representations, and their services must be unbiased and independent.

As well as providing information for other users, financial documents are crafted by corporations to meet their shareholders' expectations using a presentation of their financial affairs which may place pressure on their auditors' independence. Corporations may manage earnings to meet analysts' expectations, to avoid negative impact on share prices, and to improve the corporate image to lenders and future investors (e.g., Frankel, Johnson & Nelson, 2002; Dee, Lulseged & Nowlin, 2003; Sami & Zhang, 2003). When auditors provide NAS to their audit clients, the clients may benefit from an experienced and knowledgeable professional to assist in financial and non-financial issues; and, as noted, gain power over their auditors and perhaps impact on the auditors' independence. Such pressure on auditor independence may be viewed benignly by audit clients that have received NAS.

The methodology of this study complies with the recommendations of regulatory organisations (e.g., ISB 2000) in which the views of well-informed stakeholders are solicited to gather rich and varied data for analysis. This is in contrast to the methodologies of literature-based studies such as Elliott and Jacobson (1998), quoted in Myring and Bloom

[19] The 2006 self-assessment prepared by the SOCPA for IFAC states that SOCPA compares Saudi pronouncements with international standards and seeks to reduce differences, where possible.

(2003), who prefer the regulator's judgment in assessing auditors' independence. For auditor independence studies based on original research, data are gathered on research models which range from a rational person's perception of NAS provision by an auditor, to the effects on a quality audit of the deeper knowledge of a client's policies and practices gained by auditors through NAS. Further, variables associated with study participants' professions, roles and experiences impact outcomes from these studies and thus comparison of their findings (Bartlett, 1993).

5.4.2 Research Question 1 NAS impact on Independence

The first research question is related to the participants' view of auditor independence when NAS are involved.

Q1: How do stakeholder groups differ in their perceptions regarding the effect of NAS on auditor independence?

When regulators set parameters for an auditing environment and standards, users' perceptions of auditor independence are an important element in their deliberations. Users' opinions of auditor independence nevertheless vary in value. Financial analysts and loan providers, using documents daily, are knowledgeable and sophisticated in finance management and thus can offer quality insight. These users also represent a large number of professionals whose decisions have an impact on a substantial proportion of the general population. The views of the study's financial analyst group and the loan officer group on auditor independence, however, are expected to be similar, due to the nature of their work. .

There is little literature on academics' views of auditor independence, as researchers focus on investors and auditors. As academics are frequently called upon to contribute to the audit quality debate, they comprise a stakeholder group whose views may differ from other users of documentation. In this study, the academics' views are a benchmark for all groups due to their neutral interest in the subject of auditor independence and the provision of NAS.

5.4.3 Research Question 2 NAS and Audit Quality

The second research question is related to the stakeholders' perceptions regarding the effect of NAS on audit quality. Arruñada (1999a) argues that audit quality improves when external auditors provide NAS to their audit clients, as the providers have a deeper understanding of their clients, leading to a positive effect on audit quality. The author continues that distinguishing between material and immaterial NAS is an issue, as material

NAS may have a significant impact on auditor independence. On the other hand, immaterial NAS should not affect auditor independence to the same extent and may improve audit quality through knowledge transfer. Hence, the second research question follows:

Q2: How do stakeholder groups differ in their perceptions regarding the effect of NAS on audit quality?

5.4.4 Research Question 3 Enhancing Auditor Independence

The third research question is related to factors that may enhance auditor independence. The research framework identifies safeguards against threats to auditor independence, and policy safeguards were identified from the literature at s5.3.2, regulatory, profession-based, client-based, and auditor-based. In Saudi Arabia, where NAS provided by the auditor is banned, participants gave their views on policies to safeguard auditor independence if NAS were provided. The third research question is thus:

Q3: How do stakeholder groups differ in their perceptions regarding the efficacy of safeguards to improve auditor independence?

5.4.5 Research Question 4 Independence Threats

The classification of the range of matters impacting auditor independence, adopted from the literature, is discussed in this research (s5.3.1; self-interest, self-review, advocacy and familiarity). However, the class of threat that significantly affects auditor independence based on the perception of each stakeholder group does not appear in the literature.

Aspects of NAS, material or immaterial, have a greater or lesser impact on auditor independence. For instance, providing accounting services to the audit client opens up a self-review threat if auditors review their own work; and also if the audit firm's economic dependence on a particular audit client allows self-interest to intrude on audit independence. Nevertheless, stakeholders may not perceive such activities as impairment to auditor independence. NAS identification is therefore investigated through the perception of each stakeholder group in regard to the threat with the greatest effect on auditor independence. Hence, the fourth research question is stated.

Q4: How do stakeholder groups differ in their perceptions on the threat with the greater impact on auditor independence?

To analyse the data collected from this research statement, measures were identified from the literature (Shaub, 2004). Table 5.1 Threats to Auditor Independence and Proxy Measures, describes the measures used to estimate the effect of each threat on auditor independence.

Table 5.1
Threats to Auditor Independence and Proxy Measures

Threats to auditor independence	Description	Proxy Measure
Self-Interest	Economic and financial dependence of the auditor on the client.	Non-audit fees, overdue audit and non-audit fees, and power over the external auditor
Self-Review	Auditors review own work.	Accounting services
		Fees from accounting services
Advocacy	Acting as advocate for audit client.	The auditor's responsibility toward clients and shareholders
		Assisting clients in making decisions.
		Making decisions for the client.
		Provision of tax and zakat (tithe) services to the client.
Familiarity	Level of trust between auditor and client.	Classes of relationships affecting auditor independence.
		Recruiting executives for clients.

Ref. Shaub, 2004

The stakeholder groups may perceive the effect of NAS to the audit client differently in regards to the service provided and the nature of the auditor-client relationship.

Self-interest threat of economic dependence can occur where financial or other interests are involved in the relationship between the auditor and the client. NAS provision increases financial dependency. Audit clients who contract for NAS can gain power over their auditors, potentially compromising independence.

Self-review threat occurs when auditors audit previous work of their firm, potentially their own. Thus, the stakeholders' perceptions of auditor independence can be affected by auditor provision of bookkeeping, appraisal and other accounting and evaluation NAS.

An advocacy threat exists if an auditor is called upon to support or oppose a client management decision. Auditors may engage in decision-making and make recommendations to the client who is under no compulsion to act upon the advice. If auditors are acting as the client's advocate, this may be perceived as impacting impartiality to provide unbiased audit report (Haynes et al., 1998). Auditors in Saudi Arabia can assist clients in the preparation of tax and zakat returns; at this time such NAS is not banned through regulation or under membership standards of the Saudi Organisation of Certified Public Accountants (SOCPA). However, the government and SOCPA may review their respective stances on the auditor provision of NAS (tax and zakat services allowed) as new evidence becomes available. This thesis adds to the literature through its findings relating to the views of its study participants, who represent the major stakeholders of financial statements in Saudi Arabia.

A familiarity threat is caused by a close relationship between the auditor and the client's management (Hussey, 1999). NAS provision acerbates impaired auditor independence if a relationship between the auditor and the audit client increases the trust on that client. For instance, an auditor recruiting an executive for a client may create a personal relationship between the auditor and the executive, thus potentially affecting the auditor's independence.

5.5 Summary

This chapter presents the conceptual framework adopted in this study to analyse data obtained from various classes of stakeholders in the study groups. The framework was developed from guidelines of the ISB and based on an approach that identifies threats to auditor independence that can be mitigated by safeguards to reduce the independence risks associated with these threats. The international Federation of Accountants and the European Commission rely on core ISB concepts in this matter.

The ISB concept of auditor independence classifies threats to auditor independence into five classes of threats. These threats are: self-interest; self-review; advocacy; familiarity; and intimidation. The first four classes are believed to be caused by the provision of NAS to audit clients. In order to control such threats, certain safeguards are suggested. Such safeguards exist in the environment in which audits are performed.

Four research questions related to the participants' view regarding the issue of NAS and auditor independence are investigated. The first question is related to the participants' view regarding the impact on auditor independence. The second question examines the participants' view regarding the impact on audit quality. The third question explores the participants' view regarding certain procedures believed to enhance auditor independence. The fourth question discusses the participants' views regarding the types of threat affecting auditor independence and how these views are different. These threats to auditor independence were identified and safeguards that could be used to reduce the independence risk were explained. The following chapter presents the research method adopted in this study.

Chapter 6 Research Method

6.1 Introduction

Social research applies primarily to research within sociology and social psychology, but also within other disciplines such as social policy, human geography, political science, social anthropology and education. Sources of data for social research include authoritative origins, tradition, commonsense, and media myths (Neuman, 2006). Thus, social science issues are investigated using diverse methodologies and selection of methodology depends on a range of factors such as the area of exploration, the scope and purpose of research, and the availability of descriptive data (Robson, 2002).

This chapter is divided into six parts. The first section presents a short review of research methodology and the data collection techniques applied in social science research. The second section explains the design, planning, and research methodology for this research, whilst the third part describes the questionnaire development process. Next, the reliability and validity of the study are discussed, and the fifth section introduces the data collection procedures. The sixth section concerns data analysis.

6.2 Review of Research Methodologies

Research methodologies can be classified in various ways; however, a common distinction concerns qualitative and quantitative models. These are observational methods used to describe human behaviours that display different strengths and weaknesses (Maxwell, 2005). Each method employs specific data collection techniques (Cozby, 2007), which impact the research outcomes. Yin (1989) identifies three factors for researchers in deciding upon an appropriate model:

- type of research questions investigated;
- ability of the researcher to control behavioural events; and
- focus on current as opposed to historical phenomenon.

Table 6.1 Comparison of Qualitative and Quantitative Research Approaches illustrates differences between these two methods (Brannen, 1992).

Table 6.1
Comparison of Qualitative and Quantitative Research Approaches

Qualitative Method	Quantitative Method
• Researchers start with a generalised concept	• Researchers first define variables and variable categories
• Researchers look through a wide lens	• Researchers look through a narrow lens
• The researcher is the primary instrument for data collection	• Researchers use different techniques to collect their data
• External validity is weak	• External validity is strong
• It is associated with analytic induction	• Associated with enumerative induction
• It is theory driven	• It is theoretical and data driven
• Interpretativist paradigm	• Positivist paradigm
• Inductive approach	Deductive approach
• Idealist epistemological position	Realist epistemological position
• Adopts a non-probability sampling strategy	• Adopts a probability sampling strategy
• Used in unstructured research	• Used in structured research

6.2.1 Qualitative and Quantitative Research

A qualitative research approach is preferred by researchers for studies that focus on people behaving in a natural setting (Cozby, 2007). Qualitative research is used to understand the social world from the viewpoint of respondents through detailed descriptions of their cognitive and symbolic actions and through the richness of meaning associated with observable behaviour (Wildemuth, 1993).

Researchers who use this method tend to collect in-depth data using a few participants or cases, and within a very limited setting. This may have two different implications, according to Smallbone and Quinton (2004). The first implication is that collecting in-depth data strengthens the internal validity of the research because qualitative researchers spend enough time to ensure that their observations fit their concepts. The second is a negative implication, which is that collecting data on a few cases reduces the ability to generalise on the findings of the qualitative research.

In a qualitative methodology, a researcher is the primary instrument for data collection and analysis, contrary to the quantitative method, which uses different techniques for collecting data, and analyses data using statistical tests. Qualitative researchers usually collect data through interviews or observations in the form of written or spoken words, actions, and visual images (Neuman, 2006) which is considered a strength in terms of richness and depth of exploration and description (Myers, 2000). These investigators take an inductive approach, creating new concepts as part of their analysis; thus, their conclusions are based on interpretation. Qualitative analysis is also subject to the claim that findings cannot be generalised because the sample size is small and data are not tested to discover whether they are statistically significant or due to chance (Smallbone and Quinton, 2004).

Unlike the qualitative approach, the quantitative research method measures relationships between variables to make valid and objective descriptions on a social issue. Focusing on specific behaviours that can be easily measured, quantitative researchers collect data using large samples to generate principles that can be generalised to the larger population. Further, objectivity is served by minimising interaction with participants; thus, the interpretation of the results is not affected by the researcher's personal biases. Generated data from the quantitative process is analysed using descriptive or inferential statistics to test hypotheses and determine if significant relationships or differences exist (Taylor, 2005). The quantitative model is also used to show how phenomena can be controlled by manipulating variables. However, an absolute control cannot be achieved in the behavioural science, which may affect the model's ability to address the full range of any phenomenon (Taylor, 2005).

6.2.2 Review of Research Techniques

Social science issues can be investigated using research techniques such as case-study, archival, experimental, and survey (Robson, 2002). Each technique has particular advantages and disadvantages, depending on the type of research question, the control over actual behavioural events and the focus on current as opposed to historical phenomena (Yin, 1989). The following sub-sections discuss the most popular research techniques.

Case Study The case study model is a traditional methodology for social science studies (Hamel, Dufour, & Fortin, 1993). However, for this thesis, the case study model is inappropriate. First, Yin (1989, p. 23) defines the case study as *an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used*. Miller and Salkind (2002, p. 162) also define the case study as *the exploration of a* bounded system *or a case (or multiple cases)*. It is clear from the definitions that the case study design is suited to studies concerned with discrete facts (idiographic paradigm). It is a design that is used to gain insight and suggest propositions for further investigation (Ghauri, Gronhaug & Kristianslund, 1995). However, for studies related to abstract principles (nomothetic paradigm), the case study model is not appropriate. The case study is also criticised as using a small number of cases, which can offer no grounds for establishing reliability or generality of findings. Another criticism to the case study technique is the difficulty to validate theories such as the sociological theory, because it is based on meanings that fall outside the requirements of the theoretical process itself (Hamel et al., 1993). Despite the criticism of the case study technique, the model represents an in-depth investigation using different kinds of information (Velde, Jansen, & Anderson, 2004).

Archival Design Used in accounting and auditing literature, archival research is based on historical data and employs cross-sectional or time-series data to investigate phenomena. Further, these sources produce secondary data aggregated in databases throughout the world (Smith, 2003), the number and content of which are proliferating. This secondary data expansion is illustrated by collation of information from disclosure rules relating to audit and non-audit fees now required for commercial entities in USA and some European countries, which encourages the greater use of the archival model. Secondary data can be readily obtainable and of considerable value to many research problems (Ghauri et al., 1995). In this study, however, archival models are difficult to employ, given the limitations for accounting disclosure in the Saudi audit system, together with privacy issues with data from commercial entities.

Experimental Design Experimental research design is applicable to social science investigations, with regard to the cause and effect relationships between variables (Velde et al., 2004; Jones, 1996; Reaves, 1992). However, as the behaviour of participants is shaped by their awareness of both the experimental situation and the personal characteristics of the experimenter, the technique is open to criticism that its findings cannot be generalised to the population (Hammersley, 1992). Consequently, it was not considered relevant to this thesis.

Survey Design Survey researchers, in general, use questionnaires and interviews to collect data from a sample population: detailed information of personal attributes, attitudes, and beliefs; and past or intended future behaviours (Cozby, 2007). The technique is used to identify and examine patterns emerging from the analysis of the variables under investigation. This model involves the development and the assessment of variables, and the analysis of these variables to test the study hypotheses. In contrast to the case study model's few data sources and in-depth analysis, surveys collect data on specific variables from a larger sample, thus potentially creating a disadvantage of the model by limiting the depth of data. However, the greater range of data collected allows generalisation of the study's findings in survey research (Velde et al., 2004).

Dependent upon the purpose of the study and the research questions, an optimal selection of research design is critical to the outcomes of data collection, data analysis, and findings of this research.

6.3 Study Design and Planning

Research design, as discussed, is dependent on the purpose of the study. This study investigates stakeholders' perceptions of the effects of audit and non-audit services (NAS) on auditor independence in the Saudi environment. The study extends to the participants' perceptions of risk to auditor independence through such practices, and their views on responses to defined risk.

6.3.1 Study design

The survey design approach was adopted as an appropriate research tool to achieve the desired academic rigour for this study. The survey method is preferred, according to Carmichael and Swieringa (1968), on the grounds of relevance and efficiency; the focus of the study concerns perceptions of a comprehensive range of stakeholders in accounting and audit practices, thus enabling generalisation of its findings and external comparison of its results; and as previous regional studies of the phenomena used interview techniques (Hudaib, 2003), the survey methodology is a useful and relevant means to extend knowledge in this area of auditor independence and NAS in the Saudi environment.

The questionnaire is the preferred data collection method for survey-based studies, an efficient means for providing a matrix of data for analysis (Roberts, 1999). Questionnaires can be administered through a variety of delivery systems: face-to-face, telephone, mail, or electronically through website or e-mail. For the purpose of the current study, the standard mail questionnaire technique to collect data was employed, although distribution was substantially enhanced to maximise participation in the study.

Rea and Parker (2005) proposed the following strengths and weaknesses for distributed printed questionnaires, as follows:

Strengths:

- greater anonymity for the survey participant's information than that gained with personal contact
- survey recipients can reflect on their answers without the time pressures imposed by interview
- cost savings in a large distribution to achieve a statistically significant sample of the target population
- interviewer-induced bias is absent for survey participants.

Weaknesses

- longer time periods involved, especially if a second distribution is required
- lesser feedback opportunities for participants to query ambiguity or elaborate upon their answers
- open-ended questions may be ignored.

Despite its weaknesses, the distributed survey model is the preferred approach for a significant number of studies in auditor independence (e.g., Geiger, 1992; Miller et al., 1993; Strawser, 1994; Lasalle & Anadarajan, 1997; Lowe, Geiger & Pany, 1999); thus, this study follows suit, with the added benefit of a valid comparison with the other findings.

6.3.2 Research Objectives

The purpose of this study is to investigate stakeholder perceptions of the effect of the joint provision of audit and NAS on auditor independence in the Saudi auditing environment where such provision is prohibited. Accordingly, the objectives that support the investigation are to:

a) investigate whether the provision of NAS is perceived by study participants to affect auditor independence;
b) examine whether the separation of personnel within an audit firm enhances auditor independence;
c) identify and quantify threats to auditor independence;
d) examine the impact of the prohibition of NAS on the audit profession;
e) examine the impact of prohibiting NAS on audit quality; and
f) identify factors perceived to enhance auditor independence.

This study provides insight into the nature of auditor independence in Saudi Arabia. Importantly, it is a rigorous approach towards identifying NAS factors that impact auditor independence, an approach that serves to mitigate or eliminate barriers to auditor independence. As this is a quantitative study, the qualitative nature of interviewing numbers of participants from each group was considered. There are benefits to a study through the incorporation of qualitative analyses that enrich the discussion by elucidating issues that may arise during the drafting of the thesis. This optional methodology was not pursued, as the nature of the quantitative material fulfilled the objectives of the research.

6.3.3 Research Administration

To maintain timeliness and manage workloads during a survey-based study, a timetable is necessary to complete the research (Rea & Parker, 2005). For this study, a flexible timetable was established to accommodate any delays in completing the project. Procedures regarding questionnaire development, distribution, and follow-up are set out at s6.6.

6.3.4 Participants

In survey research, as discussed at s6.2.2, researchers are typically interested in applying study findings to a given population; thus participants are selected from sampling frames to represent that sector (Fowler, 2002). This study concerns diverse groups of financial statement users and therefore must examine differences in perception of auditor independence across financial stakeholder groups. The focus of audit governance is the protection of stakeholder interests, particularly investors and creditors who are reliant on audited financial statements and whose views are of interest to the accounting and auditing regulators (Wallman, 1996). Other stakeholders with views on auditor independence are Certified Public Accountants (CPAs), and there are differing issues for CPAs from major audit firms to those CPAs from mid-size and smaller audit entities. These issues, on which CPA perceptions are important, concern auditors, investors, and those who prepare, or author, financial statements. Finally, the perceptions of academics provide independent opinion on the effect of NAS on auditor independence, as academics have no obvious pecuniary interest in the financial statements. Figure 6.1 Study Sample Groups shows the sampling plan representing the diverse stakeholder groups, each representing the particular Saudi stakeholder population.

The aim of this study is to investigate NAS provision and auditor independence in Saudi Arabia through perceptions of stakeholders who routinely use financial information, especially audited financial statements. Retail investors, despite their protection requirements, are not included as a sample group because of their varied levels of knowledge in terms of assessing financial statements and audit standards. This variation in expertise for a group could present a deleterious effect on the quality of data and thus bias the study's results.

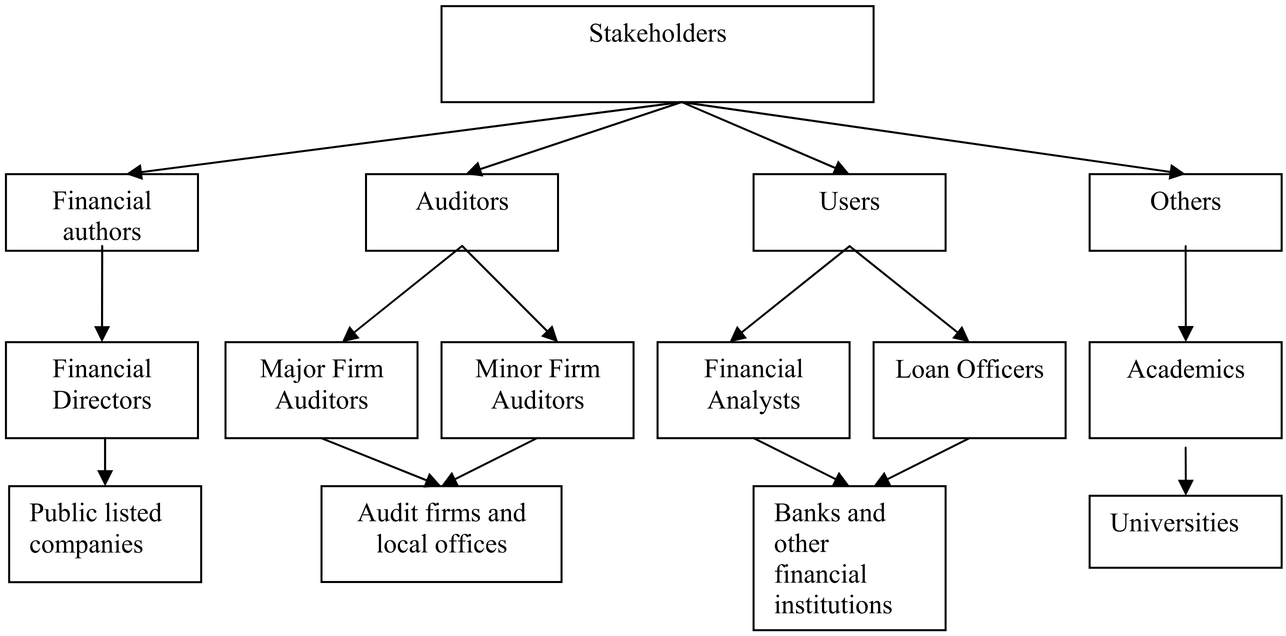

Figure 6.1 *Study Sample Groups*

The term 'sophisticated users' applies to those involved in finance matters, described in the literature, based on educational background and experience, as the most knowledgeable users of financial information, (e.g., Porter, 1993). The views of finance professionals are the subject of many studies in the audit literature (e.g., Firth, 1980; Shockley, 1981; Beattie, Fearnley & Brandt, 1999). In such studies, a variety of finance professionals was sampled; however, in this study six groups of professional, or sophisticated, stakeholders were selected: the major accounting firm auditors, that is, Deloitte & Touche, Ernst & Young, KPMG, and PriceWaterhouseCoopers; other auditors; financial analysts; loan officers; financial directors; and academics. These stakeholder participants can otherwise be grouped as auditors, preparers or those involved in financial compilation, users, and academics. Notably, the questionnaires were distributed to individuals representing audit firms, public companies, financial institutions, and academic institutions. The responses therefore represent individual views and not necessarily those of the employers.

The next section discusses the participant groups for the study and issues arising.

Auditors of Major Accounting Firms The major accounting firms, colloquially known as the Big Four, have a high profile in Saudi Arabia, as elsewhere: Deloitte & Touche; Ernst & Young; KPMG; and PriceWaterhouseCoopers. The firms operate in partnership with Saudi auditors, mainly in the three economic centres of Riyadh; Jeddah; and Dammam. The participants for this study are representative of the major firms' offices and branches, and also reflect the employee demographics for Saudi Arabia, representing various nationalities.

The distinction between the participant groups from audit firms based on size is important because the major firms have client public companies in many countries (Firth, 1997). Moreover, findings from previous studies confirm this distinction (e.g., Briloff, 1966; Shockley, 1981).

Auditors of Minor Accounting Firms This group includes all Saudi auditing firms including those in partnership with other international auditors. Saudi auditors are limited in size and scope, depending for revenue upon one or two clients, a factor which may compromise auditor independence (Teoh & Lim, 1996); thus the perceptions of this participant group differ from those of the major firms' group. The participant group included a representative from each of the 113 minor firms, a list of which was provided by the Saudi Organisation for Certified Public Accountants (SOCPA).

Financial Directors Depending upon the structure of an organisation, financial directors (or accounting managers) comprise the participant group that authors or prepares financial statements, a group previously omitted from relevant studies (e.g., Teoh & Lim, 1996; Lowe & Pany, 1996; Lowe et al., 1999; Jenkins & Krawczyk, 2002). The preparers of financial statements were selected to capture their views on the effect of the provision of NAS on auditor independence. Issues relating to financial directors as a group include use of a single external provider for both auditing and NAS, thus forming a potentially close relationship compromising professional independence (Hussey, 1999). Thus, this group's perceptions are expected to differ from those of users of financial statements. This group was sourced from the 77 public companies listed on the Saudi stock exchange (Tadawul) at the time of the survey, and the sample includes participants from all companies.

Financial Analysts Financial analysts were selected as a group to represent investors, as users of financial statements (Shockely, 1981). Saudi financial analysts, as elsewhere, are employed by financial institutions including banks and stockbrokers, and by the media. Financial analysts from each of Saudi's ten banks, plus other financial institutions sourced from the Capital Market Authority are included in the sample because their decisions as sophisticated users affect large numbers of individuals (Canning & Gwilliam, 1999; Berry, Citron & Jarvis, 1987; Bromwich, 1992). To illustrate this point, a single investor who trades in shares is solely affected by this decision. However, investment analysts and directors for banks and brokers trade for thousands of investors, thus their decisions are of greater significance than those of the individual investor. In addition, these institutional decision-makers are also included in the sample due to their influence on the financial markets. Therefore, the financial analysts' perceptions of the integrity of audited statements should provide insight into the degree of public confidence, which resides in auditors (Titard, 1971).

Loan Officers Loan officers at commercial banks manage clients' loan applications, including audited financial statements, to assess clients' credit-worthiness. Auditor independence, that is, documentation certified by an independent auditor, is crucial to loan officers' decision-making as it provides risk protection to lenders. Several researchers use loan officers as participants in investigating the effect of NAS on auditor independence (e.g., Knapp, 1985; Bartlett, 1993; Lowe & Pany, 1995). Again, the sample group includes loan officers from each of the ten Saudi banks.

Academics The last group of stakeholders comprises academics, selected because they are not directly affected by audited financial statements, however, they have great interest in auditing and accounting standards, thus their professional views regarding auditor independence can be removed from commercial interests. Although academics in Saudi Arabia usually lack practical auditing experience, their professionalism and influence on accounting ethics and standards in the country certainly amounts to highly sophisticated users of financial statements. On that basis, academics' perceptions of auditor independence add significance although the use of academic participants in previous studies is limited. Academics were recruited from all universities in Saudi Arabia that have accounting departments.

Summary Six stakeholders' groups were considered in this study. These groups include auditors, preparers, users, and independents. The first group comprises auditors who were divided into two sub-groups of auditors from major and minor accounting firms. The second group consisted of the preparers of the financial statements, represented by the financial directors in the joint stock companies listed on the Saudi Stock Exchange. The third group were the users of the financial statements represented by the financial analysts and the loan officers; lastly, the fourth group, were the independent academics. Each group has particular characteristics, which may be of consequence in the outcome of this study.

This study exceeds the reach of other research through its inclusion of a range of technical and professional groups who hold known standards of qualifications and experience, yet represent different responsibilities within the financial sector. Thus, findings from this survey may be considered influential in financial literature regarding auditor independence in the GCC countries.

6.4 Questionnaire

The objective of a questionnaire is to elicit the data relevant to the research questions, which support the study objectives, thus it is necessary to articulate questions to achieve data flows relevant to the research questions. Authors of questionnaires should consider a number of aspects to develop a viable questionnaire, beginning with the questionnaire's relevance to the research (Rea & Parker, 2005; Punch, 2003). As the questionnaire and its supporting documentation are directly or indirectly related to the study objectives, the responses and therefore the data outcomes from the questionnaire must be quantifiable. Next, the clarity of the questions is addressed, with the wording of the questionnaire simple and straightforward (Oppenheim, 1992).

The focus of this study's questionnaire is the stakeholders' perceptions of auditor independence when audit services and NAS are provided to the same client. This questionnaire was constructed from research findings and recommendations. (Appendixes I and II contain details of the questionnaire and statements). The questions, or in this case the statements, were written in an unambiguous style to facilitate reading, understanding, and completion of the questionnaire. Moreover, the reference to previous questionnaires for this study increases its reliability and validity, whilst supporting the methodology and allowing greater comparison with extant research (Rea & Parker, 2005). As part of the questionnaire's supporting material, definitions of the terms *auditor independence* and *non-audit services* were provided for clarity, and to ensure that participants were in concert with the terms before expressing their views.

Nevertheless, the concept of independence is not absolute. Carmichael and Swieringa (1968) argue that auditor independence embraces a range of values, which in this study may differ between the various stakeholder groups. This issue is further illustrated by findings that participants in some empirical studies have conceptualised degrees of independence (e.g., Bartlett, 1993). To capture a range of opinion, therefore, a five-point Likert scale was used to measure the participants' responses to statements relating to auditor independence. The response to each statement (strongly disagree, disagree, neutral, agree, and strongly agree) was scored from one (strongly disagree) to five (strongly agree).

6.4.1 Questionnaire Structure

Outcomes from a questionnaire can be significantly affected by the order of questions or statements (Rea & Parker, 2005), and the researchers present a practical guide for sequencing questions to make the questionnaire clear to participants and reduce the chance of biased responses. In this questionnaire, therefore, introductory questions were used to encourage participant continuation and completion of the survey. Demographic questions, which may raise sensitivities in participants, were placed at the end of the questionnaire to avoid controversy and gain some useful data, even if the questionnaire was not fully completed. Related questions on given issues were placed in sections to facilitate focus and concentration on a single matter; for example, a section on auditor independence issues. Lastly, a logical order for a particular series of statements was adopted, for instance, statements relating to perceived level of acceptability based on the percentages of non-audit fee to audit fee were grouped in parts two, three, and four of the questionnaire.

6.4.2 Question Format

In a study on research projects based on questionnaires, Bell (2005 p.137) states that the *more structured a question, the easier it will be to analyse.* Two question formats are normally considered for any study project based on questionnaires: closed-ended and open-ended (Rea & Parker, 2005), and a closed-ended format was selected for this study because of the nature of the study and advantages of the format, as discussed in the following sub-section.

Closed-ended Format Closed-ended format questions, or structured format questions, state the question (statement) and provide participants with optional responses. The use of a closed-ended question format improves the response rate as it reduces the time required from that of an open-ended questionnaire. Thus, most researchers prefer closed-ended format questions (Alreck & Settle, 2004). Table 6.2 Factors in Using Closed-ended Question Format shows the advantages and disadvantages of the closed-ended format (Rea and Parker, 2005; Fink, 2003).

Open-Ended Format An open-ended question format, or unstructured questions, does not depend on a selection of responses and participants create their own (Alreck & Settle, 2004). The advantages and disadvantages of the open-ended format are summarised in Table 6.3 Features of Open-ended Question Format below.

Table 6.2
Factors in Using Closed-ended Question Format

Advantages	Disadvantages
• Facilitates comparisons among participants	• Insufficient information may lead to error in responses
• Permits direct transfer of data from the questionnaire to electronic format	• Responses offered may not be relevant to participant
• Responses are directed to the options offered	• Slight distinctions in responses are not recorded
• Limits extraneous and irrelevant responses	• Participants may select a response at random
• Reduces completion time for the questionnaire	
• Participants have immediate choice of response, rather than constructing it	

Source: Rea and Parker, 2005; Fink, 2003.

Table 6.3
Features of Open-ended Question Format

Advantages	Disadvantages
• Preferable for exploratory studies	• Responses may contain irrelevant or repetitious information
• Provides rich information on the subject under investigation	• Requires greater communication skill to respond
• Provides greater freedom of expression	• Data gathered are difficult to standardise
• Participants can qualify their answers	• Questionnaire requires more time to be completed.
• Encourages participants to consider the question before responding	• Low response rate.

Sources: Rea & Parker, 2005; Fink, 2003

6.4.3 Questionnaire Content

As a professional approach gains participants' support, the questionnaire was designed and printed as a small booklet. The 12-page instrument was presented in both English and Arabic, page by page, as shown at Appendix I. The initial pages explained the research project and invited participation through completion of the questionnaire and its return, either through using the reply paid envelope provided or by direct collection (see s6.6). This introduction complied with recommendations suggested by Rea and Parker (2005) to convey the study's importance and address anticipated concerns for participants, including an assurance of confidentiality. The following pages of the survey, as discussed at s6.4 above, provided the definitions of *auditor independence* and *non-audit services*, and instructions for completing the survey. Pages four to ten contained the sets of statements for consideration of factors of auditor independence and NAS, with each statement in English and Arabic. Page eleven requested the participant's demographic information, and the last page invited comment and a final salutation and thanks.

The questions or statements were presented in seven sections. First was a series of direct and indirect statements, designed to elicit opinions regarding the impact of NAS on auditor independence. The next four sections related to a concern or issue regarding the provision of NAS to audit clients and its impact on auditor independence, identified in the research framework at s5.3 as self-interest; self-review; advocacy; and familiarity (ISB, 2000). The sections each contained statements designed to measure and compare participants' views on matters, which they considered the greater risks to auditor independence. Part six of the questionnaire concerned the perceived effectiveness of a range of safeguards to enhance auditor independence recommended by many regulatory organisations (e.g., ISB, IFAC, and ICAEW). As mentioned, the final section comprised participant demographics. The statement sets for each topic are discussed below.

Auditor Independence and Non-Audit Services In this section, the first statement considered auditor independence when an external auditor provided no other services to a client. This point, according to the literature (e.g., Hussey, 1999), clarifies a stakeholder's impression of the inherent importance of auditor independence, and participants are classified by their views on the topic. The next statement in this section draws in NAS, together with auditing services, and focuses on their effects on auditor independence. Statement 1.2 examined whether the participants agree with the existing prohibition in the Saudi audit environment of NAS provision to audit clients. Statement 1.3 assessed whether participants consider that auditors can maintain their independence while providing both audit and NAS to their audit clients. Following on this, statement 1.5 examined NAS and auditor independence when different personnel within the audit firm provide these services to the audit client. Statement 1.6 referred to outcomes that can occur when auditors provide NAS to their audit clients, which may be classified as advantages of providing NAS to audit client. These outcomes are: greater understanding of the audit clients, performance of a quality audit, providing enhanced recommendations to the audit client; and a reduced audit fee. The last statement, 1.7, examined these points in the context of the Saudi environment where, with the exception of tax and zakat services, the provision of NAS for audit clients are prohibited, which may be classified as disadvantages of prohibiting NAS provision for audit clients.

Self-interest The self-interest issue occurs *when a firm or a member of the assurance team could benefit from a financial interest in, or other self-interest conflict with, an assurance client* (IFAC, 2006, p. 43). Although there are various means to quantify financial interest, the economic bond, or economic dependent measure, was selected for this study (Shaub, 2004). The economic bond measure occurs frequently in the literature in examination of impairment to auditor independence when auditors supply additional client services, arguing that increased services to an audit client lead to an increased bond between the two, adversely affecting perceived independence (e.g., Pany & Reckers, 1984; Lowe & Pany, 1995). The issue with economic bonding is that an auditor can be over-exposed financially to a particular client by accessing other than audit fees through providing NAS, and the ratio of NAS fee to audit fee is a variable in decisions regarding impairment of auditor independence (e.g., Beattie et al., 1999; Shaub, 2004). This ratio is criticised by some researchers, who argue that it does not capture the client's status with the audit firm when the total fees from a client are immaterial to the audit firm (Ashbaugh, LaFond & Mayhew, 2003). Other measures comprise the ratio of the client's NAS fee to the audit firm's total revenue, or the total of a client's audit and non-audit fees to the audit firm's total revenue. In this study, the ratio of a client's NAS fee to the total revenue of an audit firm is used to measure the economic bond.

To gain the data for the study on the self-interest issue in the second section, participants were asked for their opinions on a series of statements. In statement 2.1, consisting of seven sub-statements, the first five sub-statements assessed participants' perceptions when the NAS fee represents 100 per cent, 50 per cent, 25 per cent, 10 per cent, or no fee, as a percentage of the audit fee. The remaining two sub-statements required views on the situation when the NAS fee represents 25 per cent, and 10 per cent, of the audit firm's total revenue.

Statements 2.2, 2.3, and 2.6 examined the effect of overdue audit and NAS fees on auditor independence. From an audit firm's perspective, overdue fees are a factor between independence and involvement in the financial interest of the client. Agacer and Doupnik (1991) investigated the issue of overdue audit fees with audit practitioners from three different countries, the United States, Germany, and the Philippines. In all cases, participants considered that overdue audit fees impaired auditor independence and this is confirmed by Lindberg and Beck (2004); when the amount is material, auditor objectivity may be impaired.

However, the issue of materiality depends on a number of factors, including economic conditions, and the size of the audit firm. Thus, in this study, materiality was not included as a variable.

Self-Review This issue occurs *when auditors review their own work or the work done by others in their firm* (ISB, 2000). NAS provision that may compromise an audit firm include in-house consultants, preparation of financial statements, and evaluation services (IFAC, 2006). In this project study, two NAS were selected: accounting and reporting services, and evaluation services. As Shaub (2004) considers that fees from accounting and reporting services alone are also a measure of self-review, further statements in the questionnaire examined whether a specific accounting or bookkeeping service can compromise auditor independence. Accounting services thus examined were: maintaining the journals and ledgers; making adjusting entries; preparing financial statements; preparing the executive payroll; and maintaining selected general ledger accounts in a private ledger. Appraisal services, in this case evaluation of a client's intangible assets, may also affect the independence of the external auditor. This section of the study questionnaire therefore included three statements concerning intangible asset appraisal: that intangible asset valuation should be under client control; that the valuation should be under the external auditor's control; that an independent third party should undertake the evaluation. These statements were also designed to be used to evaluate the auditor's ability to maintain a division between NAS and audit services for the client, and the effect on auditor independence.

Finally, as Shaub (2004) uses NAS fees for accounting and reporting services as a measure of self-review, respondents were queried regarding the auditor's accounting and reporting fees as a percentage of overall client's fees: specifically 50 per cent, 25 per cent, and 10 per cent.

Advocacy Auditing confers credibility to financial statements, with protection of the interests of owners or shareholders as the primary duty of auditors. Auditors undertaking NAS increase risk to auditor independence *when auditors or others in their firm (are) promoting or advocating for or against a client's position or opinion rather than serving as unbiased attestors of the client's financial information* (ISB, 2000). Auditor independence is at risk when auditors assume the role of management in the decision-making process. In other countries, the growing NAS services offered by auditors to their client firms is complementing the relative decline in importance of the audit function, raising concerns regarding the nature of the auditor-client relationship.

The questionnaire assesses the advocacy risk through nine statements used to determine the manner by which auditors and other stakeholders perceive the responsibility of auditors to their audit clients, compared with auditors' responsibility to their client organisations' investors and creditors. The risk assessment is extended to the participant's views on auditor support or advocacy for the client's position regarding accounting matters. Statements 4.1 and 4.2 concerned stakeholders' perceptions regarding the responsibility of external auditors to their audit clients and to the clients' shareholders or owners. Statements 4.3, 4.4, and 4.5 examined the auditors' responsibility in supporting their clients in decision-making for complex accounting transactions. Thus the study examined stakeholder perceptions in one case where auditors assist in their clients' decision-making; and another where auditors undertake such decision-making on behalf of client management. In measuring the advocacy risk to auditor independence, Shaub (2004) suggests other proxies, such as fees for tax services. Statements 4.6 to 4.9 assess whether the provision of tax and zakat services (obligatory alms) can compromise auditor independence, with 4.9 relating to three levels of fees generated from such services.

Familiarity Risk of familiarity, or unwarranted trust, arises with a close relationship between provider and client, which can concern directors, management, or employees. ISB (2000) defines familiarity as *the threat that arises from auditors being influenced by a close relationship with their clients*. This risk occurs if auditors lose focus on their professionalism and accept their clients' viewpoint or assurance of propriety. Such a relationship is therefore a determinant for auditor independence. Statements 5.1 to 5.4 examine the types of relationships that can occur when auditors provide NAS to their audit clients: personal; professional; professional and amicable; and professional but distant relationships. Statements 5.5, 5.6, and 5.8 examined the extent to which trust is acceptable between auditors and their clients. Statements 5.7, 5.9, and 5.10 sought views on whether recruitment of top managers by the audit firm can create such a relationship that may compromise auditor independence.

Factors Enhancing Independence This section explores participants' views of various means to reduce risk to auditor independence. The threat -safeguard approach includes legislation and regulations, self-regulation by professional organisations, internal auditor governance, and client governance, and the questionnaire explored these in its penultimate section. Statement 6.1 concerned the enhancement of auditor independence through the Saudi prohibition of auditors providing NAS to audit clients. A profitable NAS arrangement between auditor and client, according to Skantz and Dickins (2005), may risk auditor independence. Whilst the ratio of non-audit fees to audit fees may be declining lately, NAS still have the potential to compromise auditor independence (Nixon, 2004). Hence, statements 6.2 to 6.6 examined whether further disclosures by the external auditor of audit and NAS fees and related information may enhance auditor independence. Statement 6.7 referred to the prior approval of the client's audit committee to the organisation receiving NAS from the auditors. Statements 6.8 to 6.10, and 6.14, concerned the prohibition of specific NAS to enhance auditor independence. Statement 6.11 examined the importance to auditor independence of the separation of audit personnel and non-audit personnel within an audit firm. Participants were asked their views on whether an organisation should have its internal audit function performed by: (1) its employees; (2) its external auditor using overall audit staff; (3) its external auditor using new personnel; or (4) another external auditor. Statement 6.12 concerned governance issues for auditor firms. Finally, statement 6.13 tests whether investor selection of auditors enhances auditor independence.

Participants' Profiles Demographic data, according to Alreck and Settle (2004), are collected for surveys and include variables including age, education, employment, occupation and experience. These data identify segments, groups, or individuals who are unique, or who hold similar belief patterns. Such profile information necessary to analyse this research comprised the last section: gender, age, occupation, level of education, accounting courses undertaken, professional accreditation, and years in the current position. Once defined, opinions are expected to differ between groups, and among members of the same group.

6.4.4 Pilot Study

Although the study's questionnaire was based on researchers' recommendations, a pilot study was deemed of value to determine the comprehensiveness of the questionnaire, its acceptability, clarity of the statements, and the time required for completion. Victoria University graduate business students undertaking an auditing course voluntarily participated in the pilot, which led to the clarification of certain questions and improvements in the study's administration.

6.4.5 Arabic Translation

This study investigates auditor independence in Saudi Arabia, where Arabic is the official language, and the majority of respondents have a restricted knowledge of English; therefore, a translation of the questionnaire was required. There is, however, criticism regarding the quality of translation of research instruments, an example is a translator who is not familiar with the research area (Brislin 1986). Other issues relate to grammar and sentence construction, and dissimilarities and inconsistencies in terminology definitions (Weeks, Swerissen & Belfrage, 2007). To address these matters, the questionnaire was translated by the researcher into Arabic, his native language, then both English and Arabic versions were submitted to four native Arabic speakers who hold Ph.D. degrees in accounting from US and UK universities to review the draft and suggest any improvements. The final draft was then edited by an Arabic language professional.

The questionnaire was, however, written in English, with Arabic translations. Arabic-language numerals differ from world-standard and so-called 'Arabic numerals' and read from right to left, whilst written English language structures read from left to right. Although there was a possibility that participants could be confused by unfamiliar numeral sytstems and presentation of the Likert scale, financial personnel in Saudi Arabia are generally familiar with written English, the lingua franca of business. Secondly, few financial statements are available solely in Arabic, and these generally relate to clients of the smaller audit firms; the principals of such firms are familiar with both Saudi and international financial formats. Finally, English is taught in public and private schools throughout the Kingdom and is well-used commercially and socially. Therefore, participant confusion with the Likert scale, which was fully notated in the questionnaire material, was considered unlikely.

6.5 Instrument Reliability and Validity

To produce high quality research, two important measurement criteria are required, reliability and validity (Clark-Carter, 2004; Cozby, 2007). Whilst validity concerns the relevance of the matters being measured, reliability concerns the accuracy of the measure. Punch (1998) describes reliability and validity as the psychometric characteristics of an instrument. Thus, high quality research calls for good research design that reflects reliable and valid measurements.

6.5.1 Reliability

Reliability refers to consistency, stability, or repeatability (Punch, 1998). Reliability in measurement implies the ability to obtain the same result on repeated events (De Vaus, 2002), which includes a consistent and stable result when repeating the same study. Thus, the methodology used to obtain a reliable measurement is crucial to the research and the research results. As part of its reliability, a questionnaire must also meet standards of clarity and comprehension for the reader.

In this study, reliability is enhanced by use of a set of statements to measure each variable (De Vaus, 2002). Reliability of the instrument through *reliability of components* or internal consistency (Rosnow & Rosenthal, 2005) can be tested by evaluating internal consistency to ensure that the participants' responses follow a line of reasoning throughout the questionnaire. Techniques to test for internal consistency of a set of items include split-half techniques, the Kuder-Richardson formulas, and coefficient alpha (Cronbach's alpha) (Punch, 2003). Coefficient alpha, frequently employed in this type of research, determines through common correlations that each of a set of questions measures the same concept. The higher the coefficient, the more reliable is the set (Velde et al., 2004).

6.5.2 Validity

A quantitative research methodology, using data to be measured or quantified, is employed in this study; thus, the research focuses on its objectives to arrive at its achievements; maximising validity by ensuring that the objectives and the measures are appropriate (De Vaus, 2002). Validity is therefore a standard for the research instrument because the purpose of any research includes accuracy (Marczyk, DeMatteo & Festinger, 2005) and to control for the effects of extraneous influences and variables.

Validity techniques for any research are of three types: external validity; internal validity, and construct validity (Cozby, 2007; Rosnow & Rosenthal, 2005; Marczyk et al., 2005; De Vaus, 2002; Punch, 1998), and these are discussed below.

External Validity External validity refers to the degree to which the conclusions in the research can be generalised to the population (Marczyk et al, 2005), that is, whether the research results hold for other people, settings, times, or places (Calder, Phillips & Tybout, 1983). External validity risk for behavioural research can be classified into two areas (Clark-Carter, 2004). The first area relates to specific conditions of the study, such as the time when the data was collected, and the setting in which the study took place, whilst the second area concerns aspects of the participants.

Internal Validity According to Clark-Carter (2004, p. 41), internal validity refers *to the degree to which a design successfully demonstrates that changes in a dependent variable are caused by changes in an independent variable.* However, according to quantitative research methodologists, the cause-and-effect relationships can only be tested in experimental research (Onwuegbuzie, 2000).

Construct Validity This is described by Barret (1992, p. 14) as follows: *The concept of construct validity has evolved to be the basis for all test validation*, adding that *Construct validity means doing good science in the sense of understanding both predictor and performance domains*. Construct validity refers to the operational definitions of variables, which must be of a standard to meet the true theoretical meaning of these variables (Cozby, 2007). Accordingly, construct validity exists with measurement of the theoretical or conceptual variable.

Research Validity Enhancement In this study, various processes determine the validity of the research and its results. The questionnaire items are based on the evidence of other study questionnaires[20], with enhancements as required to satisfy conditions imposed by the study environment. Next, the questionnaire was successfully piloted by graduate students in an advanced auditing class at Victoria University. After translation into Arabic, both versions of the survey were subjected to intense scrutiny by accounting professionals familiar with the study environment and auditing principles. Finally, the Arabic version was professionally edited.

When conducting the research and collecting the data, further validation procedures were employed to maximise the study's external validity. As discussed above, there are two areas where risk exposure to external validity may occur. For the first area, data were collected between January and April 2006. A potential issue is that auditing firms' workloads peak in this season, thus jeopardising the response rate of the two participant auditing firm groups. However, all relevant auditing organisations are represented in the study. For the second area, aspects of the participants, representatives of all relevant organisations are included in the study. The possible exception was the academic group, where participants represented each university with accounting departments, not all higher education organisations, as discussed at s6.3.4. Therefore, there is a high external validity for this research and findings and conclusions can be generalised to the entire population of the six groups.

6.6 Questionnaire Procedures

A self-administered questionnaire was delivered or mailed to representatives of the selected groups to collect data for this study: major auditing firms, minor auditors, financial directors, financial analysts, loan officers, and academics. To explain the study, all

[20] Appendix II includes references for the questionnaire items.

participants received a supporting letter from King Faisal University, which is this study's sponsor, together with the questionnaire. The letter served to validate the sponsorship and stress confidentiality, thus enhancing the response rate for the questionnaire. Participants were requested to express their views through a five-point Likert scale to a number of statements on each issue.

To gain participants' cooperation and maximise the probability of response for questionnaires, Cooper and Schindler (2006) recommend attention to a number of factors, including possible errors in envelope addressing or that the intended person does not receive the questionnaire; recipient disposes of envelope without opening it; recipient sets the questionnaire aside and does not complete it. These factors were considered through the following: a professional presentation for the questionnaire as a printed booklet; distribution focused on Riyadh, Jeddah and Dammam where the questionnaire was hand delivered, with the other participants receiving mailed copies. The remaining procedures, employed in each of the three cities with all participant groups, are summarised below.

- A contact person was identified for each organisation, office, or academic institution, and briefed on the study and questionnaire.
- This person identified study participants, then accepted and distributed questionnaires and collected them when completed.
- A three-week time limit was given to complete the questionnaire.
- The contact person could then notify this researcher to collect the completed questionnaires, or return them using the self-addressed prepaid envelopes provided

For those participants located elsewhere, the questionnaire materials were mailed, with a follow-up in due course to encourage the participants to complete the questionnaire.

6.7 Analysis of Data

The questionnaire addressed the first research question of this thesis, that is, stakeholders' perceptions of auditor independence when auditors provide other services to their audit clients. Six groups of stakeholders responded to a set of statements on auditor independence on a five-point Likert scale where 1 represents 'strongly disagree' and 5 represents 'strongly agree'. This scale refines the simple dichotomous response elicited in many prior studies (e.g., Lavin, 1976). Relevant statistical tests with SPSS (statistical package) are performed and discussed in Chapters seven and eight.

6.8 Summary

The research method employed in the current study is discussed in this chapter, commencing with a review of research methodology to identify an appropriate application for this study. Qualitative and quantitative approaches are discussed, with a quantitative method adopted. Different research techniques are used to investigate social science issues, and for this study, a survey technique is selected, using a questionnaire instrument to collect the data needed. The design and planning of the research is discussed, commencing with the research design adopted. The research objectives follow: to investigate provision of audit services and NAS on auditor independence, and to examine different risk types affecting this independence.

Study participants were divided into four groups: auditors; users; authors, and academics and the evidence provided for selection of each group. The development process for the questionnaire is discussed, including consideration of the sequence of questions, question formatting, the questionnaire contents, pilot testing, and translation of the questionnaire into Arabic language. Measurement issues follow, including the reliability and the validity of the research instrument, and detail of the procedures in collection of the data.

Thus these discussions provide ample research evidence to justify the selection of the research method and the data collection procedures that were followed. It is of note that attention was paid to the methodologies of previous studies in the area and that, whilst this rigour enhances the outcomes for this study; it also allows comparison to previous research in the region and in the subject area. The next chapter introduces the descriptive analysis for the collected data and discusses the significance of the approach.

Chapter 7 Data Analysis: Descriptive Statistics

7.1 Introduction

The quantitative research methodology used in this study requires precise measurements to collect data. There is a variety of reliable and valid techniques for collecting and testing data, and to attain rich and valuable information, suites of statistical tools for summarising and interpreting that data (Gaur & Gaur, 2006). As the basis of their investigations, quantitative researchers therefore depend on statistical analysis.

Analysts have developed two main suites of statistical analysis for researchers, descriptive statistics and inferential statistics (Best & Kahn, 2006; De Vaus, 2002; Rosnow & Rosenthal, 2005). This chapter discusses the descriptive statistics of this study, which focuses on methods for producing summary statistics and plots. Chapter 8 deals with the inferential statistics employed to elicit the findings for this research.

Descriptive statistics are used to describe the data in terms of the characteristics of the variables under investigation (Marczyk, DeMatteo & Festinger, 2005). Describing the data is a means normally used to summarise variables in a sample prior to analysing the main hypotheses. Before starting the analysis procedures, it is recommended that the data be prepared for analysis. To describe the analysis employed, this chapter consists of three sections. First, the data preparation procedures are described, followed by frequency distributions of the demographic information. Finally, frequency distributions and central tendency measures of the relationship between auditor independence and the provision of non-audit services (NAS) are presented.

7.2 Data Preparation

To ensure the accuracy and completeness of data, preparing it for statistical analysis is an important step. Certain procedures, coding, entry and editing the data are required before starting the statistical analysis (De Vaus, 2002).

7.2.1 Data Coding

Data coding is a procedure used by researchers to extract categories and values of a variable so that responses can be translated to an appropriate form suitable for statistical analysis (De Vaus, 2002). By grouping similar responses, the data can be made manageable. It is important that the codes are differentiated and organised in a framework or pattern to facilitate interpretation, cross-referencing and comparisons of the emerging information.

In this study, nominal and ordinal scale data were converted into numerical values at the questionnaire design stage, where the response of each question or statement was numbered. For the statements related to auditor independence and non-audit services, which cover Part 1 to Part 6 of the questionnaire (Appendix I), participants were asked to provide their responses on an ordinal, five-point Likert scale, and they were offered five choices: strongly disagree; disagree; neutral; agree; and strongly agree. A method commonly practised among researchers was followed to code these choices, where a numerical value was assigned to each choice (i.e., 5 if strongly agree, 4 if agree, 3 if neutral, 2 if disagree, and 1 if strongly disagree). For the demographic questions that contain nominal and ratio data, a numerical value was assigned to each response in each question. Applying this method helps analyse the data when using a common statistical software package and also allows comparison of the results of this study with those of previous studies. Moreover, it helps assist with data entry.

7.2.2 Data Entry

Data entry commences by creating a computer file or database to hold the raw data obtained from the returned questionnaires. The raw data can be entered using one of the three common methods: a spreadsheet document, a database document, or a dedicated data entry program (Alreck & Settle, 2004), and the process of entering these data is similar for each method. Common statistical packages are designed especially for data entry and the Statistical Package for the Social Sciences (SPSS) is a widely used form of data entry and analysis (Byrne, 2002; Alreck & Settle, 2004).

In this study, the raw data were entered using SPSS. The processes followed to enter the data into SPSS were as follow:

- Each row represents a case.
- Each column represents a variable.
- Each cell contains one response coded in a numerical value.
- Each case has only one response or value for each variable.
- A dot was entered to represent any missing response.

After entering the data, data should be edited to ensure its accuracy and completeness and that it is acceptable for analysis (Robson, 2002). Two types of errors, identified by Alreck and Settle (2004), may be found when editing the data: first, variables keyed to the wrong columns; and second, values exceed the acceptable range for the item. Certain editing procedures were taken into consideration to ensure the accuracy of the entered data of this study. The data were first entered by the researcher and then reviewed by another person for entry errors. Preliminary editing analyses producing frequency tables were carried out to check for maximum and minimum values. A few entry errors were found and then were corrected by referring to the completed questionnaire by case number.

7.2.3 Response Rate

The sample of this study consists of six stakeholders' groups. These groups are: major auditing firms; minor auditing firms and offices; loan officers; financial analysts; financial directors; and academics. These stakeholder participants can otherwise be grouped as auditors, authors or those involved in financial compilation, users, and academics. Notably, the questionnaires were distributed to individuals representing audit firms, public companies, financial institutions, and academic institutions (s6.3.4). The intended participant lists covered the entire population of all groups, with the exception of the academic group and this was defined for the purposes of this study as accounting faculty in Saudi's universities. Thus, academics external to these universities were not participants to this study. The categorised groups, questionnaires distributed, and number of questionnaires returned are shown at Table 7.1 Category Participants, below.

Table 7.1
Category Participants

Participant Category	Questionnaires Distributed (N)	Modified Distribution (N)	Returned (N)
Major Auditors (B4)	138	90	41
Minor Auditors (NB4)	184	144	58
Loan Officers (LO)	129	99	40
Financial Analysts (FA)	82	69	44
Financial Directors (FD)	128	78	66
Academics (AC)	164	100	53
Total	**825**	**580**	**302**

Initially, 825 questionnaires were distributed, through designated contacts in participant organisations. The contact identified potential respondents in each relevant category (s6.6).

However, it later emerged that many potential participants selected by the contacts were ineligible, as they did not fulfil the requirement that they relied on audited financial statements for their financial decisions regarding a particular firm. The questionnaire distribution was subsequently modified in consultation with each organisation's contact to ensure that the actual population of all Saudi participant categories were approached. The final distribution number was 580 questionnaires.

Of the modified distribution total, 302 questionnaires were returned, three of which were incomplete and thus not acceptable for the purpose of the research. In research, statistical rigour does not extend to determining standards for acceptability of incomplete questionnaires; however, based on this researcher's judgement, 40 per cent or more unanswered questions were eliminated for the purposes of this study. Thus, the number of usable questionnaires was 299 summarised in Table 7.2, Response Rates.

Table 7.2:
Response Rates

Participants	Questionnaires Distributed (N)	Questionnaires Received (N)	Response Rate per Category & per Total Categories(%)	Response Rate Total Received (%)
Major Auditors	90	41	45.6	13.7
Minor Auditors	144	57	39.6	19.1
Loan Officers	99	40	40.4	13.4
Financial Analysts	69	44	63.8	14.7
Financial Directors	78	65	83.3	21.7
Academics	100	52	52	17.4
Total	580	299	52	100

Question 3 in the demography section asked for the respondent's occupation, which was then allocated to one of the six stakeholder categories. Table 7.2 analyses the responses for each category, the overall response rate of which was 52 per cent. Findings in the literature are that response rates for mailed questionnaires are generally poor, and commonly response rates average 30 to 50 per cent (Wallace & Mellor 1988).

For the major audit firm category, 90 questionnaires were distributed to corporate headquarters and their branch offices of which 41 usable responses were received, a response rate of 46 per cent, and 13.7 per cent of the total forms received. At the time the data were collected, the next category of minor auditors consisted of 113 Saudi audit firms and offices[21]. For this group, 144 questionnaires were distributed and 57 usable responses were received, a response rate of 40 per cent, and just 19 per cent of the total forms returned. The loan officer category participants were sourced from the ten Saudi banks listed on the Saudi Stock Exchange (Tadawul). Forty acceptable responses were received from the 99 loan officers identified, or a 40 per cent response rate. The category of financial analyst participants was similarly employed by the ten listed banks, together with analysts employed by Saudi brokers. Sixty-nine questionnaires were distributed and 44 usable responses were received, the second highest response rate for all categories of 64 per cent. This indicates that financial analysts rely on the audited financial statements when making investment decisions thereby independence is a fundamental issue. The financial director category represent all finance directors from the 78 joint stock companies listed on Tadawul at the time the data were collected; thus, 78 forms were distributed. The directors category were the highest number of participants responding, with 65 (83%) acceptable responses were received, 21.7 per cent of the total. The academic category was sourced from all public universities in Saudi Arabia that have accounting and finance departments. Thus, for a sample of 100, 52 usable responses were received.

The high response rate (52%) suggested that non-response bias should not be a major problem. Nevertheless, conventional comparison between early and late respondents was carried out to insure the reliability and validity of the data. The results indicated that there were no significant differences in opinions about independence, response to statements or other demographic data, which imply the absence of non-response bias.

7.3 Descriptive Statistics

Describing the study's findings through use of tables, graphs, and statistics is the focus of this section. Since quantitative research entails measurements of a number of variables across a sample, or in this case the population, various measures may be used to summarise and understand data (Punch, 1998). Simple frequency distributions, central tendency measures, variations, and relationships between variables using cross-tabulations are discussed in this section to summarise the data collected for this study.

[21] Source: Saudi Organization for Public Accountants www.socpa.org.sa

7.3.1 Demographic Frequency Distributions

Frequency distribution, plotting the number of times each observation occurs in a set of data, is useful in identifying any overall pattern of the data, (Rosnow & Rosenthal, 2005). Frequency distribution can also be useful for different types of graphs such as pie chart, bar graph or frequency polygon (Cozby, 2007). In this sub-section, frequency distributions for the demographic variables of the participants are shown.

Gender In most educational institutions in Saudi Arabia, a finance education is available to female and male students. However, due to cultural and religious factors, males tend to dominate most positions in the working environment. Male auditors dominate the Saudi environment, and female financial analysts generally work in the female branches of banks and provide their services to the banks' female customers. Since inception in 1994, the Saudi Organization for Certified Public Accountants (SOCPA) records show of a single Saudi female who passed the Saudi CPA, in 2007 (SOCPA, 2007). Table 7.3 Gender, shows the participants' gender across the categories.

Table 7.3 Gender shows twelve participants were female, a mere 4.1 per cent of the survey responses, with nine reporting that they were employed in educational institutions and three as financial analysts.

Table 7.3
Gender

Participants	Male	Female	Total*
Major Auditors	41	0	41
Minor Auditors	54	0	54
Loan Officers	40	0	40
Financial Analysts	40	3	43
Financial Directors	65	0	65
Academics	42	9	51
Total	282	12	294
Percentages	95.9	4.1	100

* Differences between table totals relate to questionnaire responses

Industry At March 2006, there were 78 joint stock companies listed on Tadawul categorised into eight sectors, all of which were surveyed commensurate with the aims of this study. Table 7.4 Finance Director Responses, by Sector of Tadawul (Saudi Stock Exchange) shows these sectors and the distribution of the financial directors' responses.

The highest percentage of the response rate in the financial director group was from the Industrial Sector (35.1%) followed by the Service Sector (29.8). Whilst these sectors represent the largest concentration of Finance Directors, their response rates were also far higher than the other sectors.

Table 7.4
Finance Director Responses, by Sector of Tadawul (Saudi Stock Exchange)

Sectors	Listed Companies (N)	Responses* (N)	Response Rate (%)
Banking	10	2	5.3
Services	19	17	29.8
Industrial	28	20	35.1
Electrical	1	1	1.8
Telecom	2	2	3.5
Agriculture	9	6	10.5
Cement	8	8	12.3
Insurance	1	1	1.8
Total	78	57*	100

* 8 respondents did not indicate their sectors

Age Table 7.5 Age Distributions for all Respondent Groups shows the age distributions for all respondent groups.

Table 7.5
Age Distributions for all Respondent Groups

	Years of Age						
Participant Category	< 25 Percentage	25-34 Percentage	35-44 Percentage	45-54 Percentage	55-64 Percentage	> 64 Percentage	Total* (N)
Major Auditors	12.2	53.7	17.0	4.9	12.2	0	41
Minor Auditors	1.8	50.0	26.8	16.0	3.6	1.8	56
Loan Officers	0	45.0	35.0	15.0	5.0	0	40
Financial Analysts	2.3	52.3	20.4	20.5	4.5	0	44
Financial Directors	3.1	12.3	30.7	35.4	15.4	3.1	65
Academics	2.0	8.0	38.0	38.0	12.0	2.0	50
Total	**3.4**	**34.8**	**28.4**	**23.0**	**9.1**	**1.4**	**296**

* Differences between table totals relate to questionnaire responses

Of the respondents, 34.8 per cent and 28.4 per cent were aged 25 to 34 years and 35 to 44 years, respectively. However, when breaking down the age distributions, most respondents were aged 25 to 34 years for the first four groups: major auditors, minor auditors, loan officers, and financial analysts. The majority of respondents for the financial director and academic groups were aged from 35 to 54 years. This is explained by the fact that academics spend their early years acquiring further qualifications, while the financial directors achieve their positions through experience. The following tables, Tables 7.6 and 7.7, which show the distributions of education and experience, respectively, confirm this finding.

Education Table 7.6, Level of Education, illustrates the distributions for all groups.

With the exception of the academic group, the majority of respondents from all categories hold bachelor degrees. Whilst the greater majority of academics (89.8%) have doctorates, this is an expected outcome as it is a requirement for employment in the field in Saudi Arabia. Other categories differ in their career requirements. The high level of bachelors' degrees for both category of auditors, 73.1 per cent for major firms and 92.7 for minor firms, respectively, is explained by the fact that audit firms recruit personnel who, after gaining some experience, can achieve CPA qualifications.

Table 7.6
Level of Education

Participant Category	High School Percentage	2-year Diploma Percentage	Bachelor's Degree Percentage	Master's Degree Percentage	Doctorate Percentage	Other Percentage	Total (N)
Major Auditors	0	0	73.1	22.0	0	4.9	41
Minor Auditors	0	0	92.7	5.5	0	1.8	55
Loan Officers	2.5	2.5	57.5	37.5	0	0	40
Financial Analysts	0	4.5	52.3	38.6	2.3	2.3	44
Financial Directors	1.6	1.6	67.2	20.3	3.1	6.3	64
Academics	0	0	6.1	4.1	89.8	0	49
Total	0.7	1.4	59	20.1	16.1	2.7	293

* Differences between table totals relate to questionnaire responses

The General Rules for the Saudi CPA Examination state that a bachelor's degree is necessary to sit for the Saudi CPA Examination. Over one third of both the loan officers and the financial analysts hold master's degrees (37.5% and 38.6%) and approximately half have bachelor's degrees. Two-thirds (67.2%) of the finance directors hold bachelor degrees.

Accounting Courses The number of accounting courses completed by the participants during their education was used as a proxy for accounting knowledge. The number of accounting courses reported by the participants is illustrated in Table 7.7 Accounting Courses Undertaken.

Table 7.7
Accounting Courses Undertaken

Participant Category	Number of Courses Undertaken				
	< 3 Percentage	3 – 6 Percentage	7 – 9 Percentage	> 9 Percentage	Total (N)
Major Auditors	0	12.8	12.8	74.4	39
Minor Auditors	0	0	14.0	86.0	50
Loan Officers	2.5	37.5	17.5	42.5	40
Financial Analysts	21.4	31.0	14.3	33.3	42
Financial Directors	1.7	10.2	15.3	72.9	59
Academics	0	17.0	6.4	76.6	47
Total	4.0	17.0	13.4	65.7	277

* Differences between table totals relate to questionnaire responses

Two-thirds of respondents (65.7%) reported completion of nine or more accounting courses, with the greater rates reported by auditors from the minor (86%) and major (74.4%) accounting firms. This indicates that audit firms prefer recruiting accounting graduates over non-accounting graduates.

In Saudi Arabia, an accounting or finance bachelor's degree generally requires a minimum of 9 accounting courses. Financial analysts reported the lowest rate of accounting courses, as 21.4 per cent had completed three courses or less.

Experience Measured by the number of years the respondents have been in their occupations, Table 7.8 Career Experience shows the experience distribution for all categories.

Table 7.8
Career Experience

Participant Category	Years of Career Experience						
	< 5 Percentage	5-10 Percentage	11-15 Percentage	16-20 Percentage	21-25 Percentage	> 25 Percentage	Total* (N)
Major Auditors	29.3	36.6	12.2	4.9	4.9	12.2	41
Minor Auditors	20.0	40.0	18.2	7.3	9.1	5.5	55
Loan Officers	27.5	25.0	22.5	15.0	7.5	2.5	40
Financial Analysts	52.3	22.7	11.4	4.5	6.8	2.3	44
Financial Directors	20.3	15.6	29.7	9.4	6.3	18.8	64
Academics	8.0	16.0	12.0	24.0	10.0	30.0	50
Total	25.2	25.5	18.4	10.9	7.5	12.6	294

* Differences between table totals relate to questionnaire responses

Half of all respondents (50.7%) reported 10 years' occupation experience or less, with one quarter of these having less than five years business experience. This may result from the Kingdom's rapid economic expansion of the last decades, as many more job opportunities became available over this time, and low levels of work experience confirm the finding at Table 7.5, where 38 per cent of respondents were under 35 years of age. Expatriate employees may also have some impact on the short career profile evidenced in this study.

Of the participant categories, major firm auditors reported the lowest level of experience, with two-thirds (65.9%) having less than 11 years' experience; minor firm auditors were similar, with 60% reporting ten years or less experience. On the other hand, 30 per cent of academics reported 25 years or more career experience, and finance directors followed at 19 per cent. Thus, academics, with tenure, continue their careers at university and finance directors, as noted, are career financiers promoted to their companies' boards.

Professional Membership Table 7.9 shows the professional memberships reported, by category of participant, thus indicating achieving a certification from that association.

Table 7.9
Professional Membership

Participant Category	SOCPA (Saudi CPA) Percentage	CPA (US CPA) Percentage	CIA (Certified Internal Auditor) Percentage	CMA Certified Management Accountant Percentage	Other Percentage	Total* (N)
Major Auditors	14.8	18.5	0	7.4	59.3	27
Minor Auditors	17.1	11.4	0	5.7	65.7	35
Loan Officers	0	0	0	5.6	94.4	18
Financial Analysts	3.7	7.4	0	3.7	85.2	27
Financial Directors	16.7	16.7	2.8	2.8	61.1	36
Academics	0	5.9	0	5.9	88.2	17
Total	10.6	11.3	.6	5.0	72.5	160

* Differences between table totals relate to questionnaire responses

As about half the respondents replied to this question, the result is an indication only of association membership in Saudi Arabia. Moreover, nearly three-quarters of those who did respond reported unidentified or no affiliation to an association. The few respondents who did claim US or Saudi CPA membership were generally from the auditor or finance directors' categories. A third of the financial director's group reported either Saudi CPA or US CPA certification, with the remaining two-thirds having either no affiliations or CA, CMA, or CPA certificates from different countries, perhaps other Arab and Southern Asian countries. The expatriates are presumed to have been educated and hold affiliations from their home countries (Hudaib, 2003).

Country of Final Graduation Table 7.10, Country of Final Graduation shows where respondents received their highest level of education. The non-Saudi countries can be classified as Saudis who won scholarships to study abroad, or expatriates who are working in the Kingdom. However, public higher education in the Kingdom is restricted to Saudi citizens, thus respondents who received their final graduation in Saudi Arabia are Saudis. Private institutions began educating non-Saudis only recently.

Table 7.10
Country of Final Graduation

Participant Category	Saudi Arabia Percentage	Australia Percentage	USA Percentage	Europe Percentage	Other Percentage	Total (N)
Major Auditors	32.4	0	8.1	8.1	51.4	37
Minor Auditors	14.3	0	10.2	2.0	73.5	49
Loan Officers	38.5	0	15.4	17.9	28.2	39
Financial Analysts	22.7	0	29.5	11.4	36.4	44
Financial Directors	27.9	0	13.1	4.9	54.1	61
Academics	10.2	2.0	6.1	30.6	51.0	49
Total	23.7	.4	13.6	12.2	50.2	279

* Differences between table totals relate to questionnaire responses

One third of participants from major auditing firms received their highest qualification in the Kingdom, and just 14 per cent of the auditors from the minor firms, confirming prior findings of Hudaib (2003). About one quarter each of loan officers and financial analysts, 22.7 per cent and 27.9 per cent respectively, reported Saudi qualifications. Half of all respondents; of note, nearly three-quarters of auditors from minor accounting firms (73.5%); reported qualifications from developing economies, presumably Arab and South East Asian countries. The financial analysts' group, with a relatively high Saudi quota, nevertheless included 40.9 per cent who reported qualifications from USA and Europe, mostly Britain, where the provision of NAS to the audit client is allowed. The independent academic category participants were predominantly (89.8%) educated abroad. About one third were educated in Europe, generally Britain, with half receiving their degrees from elsewhere, the majority being Egypt.

This analysis is therefore influenced by expatriate respondents, which may affect the respondents' perceptions regarding the effect of NAS provision on auditor independence. This is emphasised by the fact that over two-thirds (77%) of respondents received their highest degree from overseas such as USA, Europe, Pakistan, Egypt and Jordan, and the provision of NAS to audit clients is allowed in most of these countries.

Level of Interest Participants were asked whether they would like to receive a copy of the results of this study and if so, to provide their contact information. The groups' answers can be used to obtain the level of interest of each group in this study. Table 7.11 Interest in Results shows the respondents' answers of this question.

Table 7.11
Interest in Results

Participant Category	Yes Percentage	No Percentage
Major Auditors	73.0	27.0
Minor Auditors	87.8	12.2
Loan Officers	54.1	45.9
Financial Analysts	70.3	29.7
Financial Directors	75.9	24.1
Academics	82.1	17.9
Total	74.7	25.3

* Differences between table totals relate to questionnaire responses

Three quarters of respondents requested notification of the study results. While 87.8% of the minor firm auditors showed their interest in this study, just half (54.1%) of the loan officers asked for a copy of the results. This latter result was not expected, as loan officers are the user group who utilise audited financial statements when processing loan applications from firms.

7.4 Auditor Independence and NAS

The aim of this study is to investigate the relationship between auditor independence and NAS through examining the stakeholders' perceptions of the effect of the provision of NAS on perceived auditor independence. The participants were categorised into six groups, auditors from major auditing firms, auditors from minor auditing firms, loan officers, financial analysts, financial directors, and academics. These six groups were further classified into four main groups namely: auditors; users; producers; and academics. Previous researchers typically take the perspective of auditors, users or producers, therefore this study included academics to provide independent opinion regarding each issue under investigation. This section presents the stakeholders' perceptions concerning various issues related to auditor independence and NAS. These issues were considered after reviewing the literature and a complete index showing the reference of each statement used is shown in Appendix II.

7.4.1 Implications of Auditor Independence

Independence, through client and user trust, is an important asset for all auditors. Independence increases the effectiveness of the audit by providing assurance that the auditor will plan and execute the audit objectively. It enhances the quality of the audit and contributes to the effectiveness of the financial statements for investment decisions (Lindberg & Beck, 2004). In this study, participants were asked to give their perceptions regarding the importance of auditors' independence when auditing clients' financial statements. Table 7.12 Importance of Auditors' Independence shows the respondents' perceptions of the importance of auditor independence. Some prior studies investigated this matter to demonstrate the importance of auditor independence as an auditing standard (e.g., Schulte, 1965; Beattie, Brandt, & Fearnley, 1999).

Table 7.12
Importance of Auditors' Independence

Statement 1.1 Auditors have to be independent when auditing for their clients

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	0	0	0	0	0	0
Disagree	0	17	7.5	9.1	3.1	1.8
Neutral	2.5	1.8	0	0	3.1	1.9
Agree	19.5	21.1	17.5	15.9	12.3	11.5
Strongly agree	78.0	75.4	75.0	75.0	81.5	84.6
Total (N)	41	57	40	44	65	52
Mean	4.76	4.70	4.60	4.57	4.72	4.79
SD	0.49	0.60	0.84	0.90	0.67	0.57

Table 7.12 shows that 16.1 per cent and 78.6 per cent of all respondents answered *agree* and *strongly agree*, respectively, to the statement that auditors must be independent when performing auditing services. Thus, 94.7 per cent of respondents attach a special importance to the need for an auditor to be independent; that is, that nineteen of every twenty participants recognised the importance of auditor impartiality. Interestingly, academics scored the highest mean while financial analysts scored the lowest, which may be explained by the strength in

accounting backgrounds of the academic category (refer to Table 7.6). In addition, major firm auditors evinced the lowest variation among their responses, indicating a greater consensus of opinion. The user categories, loan officers and financial analysts, showed the largest opinion variations, 0.841 and 0.9, respectively, which may indicate a lesser regard for the protocols of auditing. User categories could be expected to focus more on financial content than the structures and safeguards of the documents with which they work.

In this study, the question of auditor impartiality was posed in a manner to facilitate comparison with previous studies and data gathered on the same five-point response scale. In the United Kingdom, for instance, Beattie et al., (1999) reported that, in their study of the importance of perceived independence, a category of partners in audit firms scored a greater mean (4.65) over financial directors and financial journalists categories. Hartley and Ross (1972) also reported that the group of US CPAs scored the highest mean (4.82) over the chartered financial analysts and the financial executives. This study concurs with these findings.

7.4.2 Effects on Auditor Independence

With the exception of tax and zakat services, Saudi Arabia bans auditors from providing other than audit services to their audit clients. The majority of studies investigating stakeholders' perceptions of auditor impartiality in the case of a firm providing both audit and NAS services to the same client were conducted in countries where this provision is allowed. A comparison between the two different regulatory environments allows further insight into the issue of auditor independence and NAS.

The provision of NAS with audit services heightens risk to auditor independence as there is a perception of a conflict of interest through an auditor becoming dependent on the increase in fees from a corporate client (Craswell, 1999). Table 7.13 Audit Independence when NAS is provided shows the respondents' views regarding two questions concerning the relationship between auditor independence and the provision of NAS. The first question relates to Statement 1-2: Auditors should be legally allowed to provide NAS for their audit clients; the second Statement 1-3 Auditors can maintain their independence when providing audit and NAS to their audit clients. The participants were asked the first question, if auditors should be legally allowed to provide NAS for their audit clients because NAS provision is banned in Saudi Arabia.

Auditors The first question in Table 7.13 as to whether auditor-provided NAS should be legalised in Saudi Arabia drew mixed results from the participant categories, notably from auditing firms' respondents. A majority of major auditors (52.5%, mean of 2.90) do not support NAS provision for their audit clients; whereas a greater majority of the smaller auditors (69.1%, mean of 3.47) support NAS provision. This finding raises the possibility that smaller auditors are attracted to the opportunity of NAS consulting.

Table 7.13
Audit Independence when NAS Provided

Statement 1.2 Auditors should be legally allowed to provide NAS for their audit clients

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	15.0	10.9	15.0	22.7	21.5	23.5
Disagree	37.5	12.7	30.0	31.8	18.5	9.8
Neutral	7.5	7.3	10.0	13.6	9.2	13.7
Agree	22.5	56.4	42.5	22.7	27.7	39.2
Strongly agree	17.5	12.7	2.5	9.1	23.1	13.7
Total (N)	40	55	40	44	65	51
Mean	2.90	3.47	2.88	2.64	3.12	3.10
SD	1.39	1.20	1.20	1.31	1.51	1.42

Statement 1.3 Auditors can maintain their independence when providing audit and NAS to their audit clients

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	9.8	7.0	5.0	13.6	12.3	19.2
Disagree	26.8	10.5	37.5	34.1	18.5	17.3
Neutral	12.2	7.0	20.0	18.2	16.9	19.2
Agree	36.6	61.4	30.0	29.5	32.3	38.5
Strongly agree	14.6	14.0	7.5	4.5	20.0	5.8
Total (N)	41	57	40	44	65	52
Mean	3.20	3.65	2.98	2.77	3.29	2.94
SD	1.27	1.08	1.10	1.16	1.32	1.26
Overall Mean	3.04	3.58	2.93	2.70	3.21	3.01
Overall SD	1.22	1.07	1.08	1.19	1.33	1.19

Users Loan officer respondents were equally divided (45% each agreement and disagreement, mean of 2.88) in allowing auditor-provided NAS; however, the mean occurred due to 15 per cent of the group strongly disagreeing with the proposal. A majority of the financial analysts' group (54.5%, mean 2.64) disagreed with the NAS proposition. These results show that, whilst most financial analysts do not agree with auditors providing NAS to their audit clients, there are a substantial minority (31.8%) who agree. The majority results are consistent with those of Hudaib (2003), who found that investment analysts and credit managers were concerned regarding the independence of external auditors providing NAS to their audit clients, due to the inherent financial interest of auditors.

Producers_A slim majority of financial directors agreed to auditor-provided NAS (50.8%, mean 3.12), again with a substantial authorship minority of 40 per cent disagreeing. The authors of the financial statements who agreed with NAS provision were perhaps considering that clients may benefit from NAS provided by an auditor through their prior auditing relationship and thus the auditor's in-depth knowledge of the client's financial position.

Academics A slim majority of the academic group agreed on the provision of NAS services to audit clients, (52.9%, mean 3.10), with a third disagreeing with the proposition.

The findings of this study are that small-firm auditors strongly support the provision of NAS to audit clients, and academics show weak support to the statement. Corporation auditors, financial analysts and finance directors weakly disagree to auditors' provision of NAS. Loan officers, neutral, are an indicator to the view that, with the exception of the small audit firms, this question was usually answered from a personal perspective.

The second question of table 7.13 concerns the study participants' responses to the proposition of audit impartiality when NAS are provided.

Auditors Both auditor categories agreed that auditors can maintain their independence when NAS are provided to audit clients. Major auditors (51%, mean 3.2) were in weak agreement, with the smaller audit firms again showing strong agreement (75.4%, mean of 3.65). These results are expected, as auditors benefit financially from the provision of NAS to their audit clients. An interesting finding is that major auditors weakly disagreed with allowing auditors to provide NAS to their client firms whilst weakly agreeing that independence can be maintained when providing NAS to their audit clients. This difference may be attributed to a statistical anomaly. The small audit firms were consistent regarding both issues: auditors should be allowed to provide NAS to their audit clients and auditors can maintain their independence in this position.

Users The loans officer and the financial analyst category participants report that auditors cannot maintain their independence when providing NAS, although both had a high proportion of neutral responses, or abstentions. For the loan officer group, 42.5 per cent disagreed with the proposition that impartiality could be maintained with NAS and 20 per cent were neutral; the financial analysts' responses were that 47.7 per cent disagreed and 18.2 per cent were neutral. Both groups provided consistent answers with the first statement regarding legal provision of NAS. The high proportion of neutral responses is an indicator that participants were responding from a personal viewpoint, and apart from small auditors, not evincing a coordinated professional response to the questions.

Producers The bare majority of financial directors (50.2%, mean of 3.29) agree that auditors providing NAS can remain independent when providing NAS to their audit clients. The financial directors are consistent in their views; that NAS provision should be legal for auditors and that they can remain impartial whilst doing so. These results are consistent with Hussey (1999) who found that the majority of the finance directors in both public and private UK companies did not believe that auditors should be prevented from providing NAS for their audit clients.

Academics The majority of the academics, 44.3 per cent, agreed that auditor impartiality can be maintained if they also provide NAS, with a high 19.2 per cent choosing the neutral option. Yet the majority of the academic participants does not support the notion that auditors should be allowed to provide NAS for their audit clients. This again appears to be a personal response, not so much as a professionally coordinated view.

The differences between groups' means, and implications from these, are discussed in chapter 8.

7.4.3 Advantages of Auditors Providing NAS

External auditors examine their clients' accounts to enhance the reliability of the statements for other stakeholders (Arruñada, 1999a). The effectiveness of the audit requires a level of understanding of the audit client's activities by the external auditor. Thus, providing NAS to an audit client may have some advantages in improving audit quality. Joe and Vandervelde (2007) examined whether auditors could transfer knowledge from a non-audit task to an audit task. Their findings were that auditors who completed the non-audit task transferred the knowledge about client risks and provided higher audit risk assessments than auditors who only reviewed the non-audit work-papers; however, they concluded that in order to obtain a positive knowledge transfer from NAS to audit services, the same personnel must work on both engagements.

In this study, participants were asked their views regarding four statements designed to measure the advantages of allowing auditors to provide NAS to the audit client. Table 7.14 Advantages of auditors providing NAS illustrate these four statements.

The majority of participants and categories agreed with Statement 1.6a, providing NAS to an audit client assists auditors in understanding clients' businesses. The major auditors recorded the highest level of agreement (65.8%) while the academic group recorded the lowest percentage (40.5% agreed). For the loan officer and the financial analyst groups, 57.5 per cent and 50 per cent, respectively, agreed with the statement. The financial directors also agreed, 62.6 per cent. The finding is that the majority of respondents agreed that providing NAS to an audit client assists higher understanding of the client's business, which, in turn, should be reflected in the quality of audit. Statement 1.6b, NAS provision enhances the audit process evinced a lesser response; the majority of only three groups supported this statement (both auditor categories 47.5%, 56.4%, respectively, and the financial directors group 47.7%). As auditors and the financial directors of audit clients are directly involved with NAS, they are in a better position to judge whether the NAS provision improves audit quality. Further, the provision of NAS is in the interest of both groups. These views are commensurate with previous research findings that NAS enhance the auditors' knowledge of the client, leading to a more efficient and effective audit (e.g., Simunic, 1984; Ryan et al., 2001).

The majorities of the remaining categories (loan officers, financial analysts and academics) disagreed with statement 1.6b, NAS, which is that such services enhance the audit process. These respondents do not expect auditors to provide a better audit through greater understanding, and the provision of NAS does not enhance the audit process. This view is supported by previous studies that failed to find positive effects of NAS through knowledge spillover on audit quality (e.g., Son, 2005).

Table 7.14 *Advantages of auditors providing NAS*

Statement 1.6a Helps auditors to understand their clients better						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	7.3	5.3	2.5	11.4	1.6	15.4
Disagree	14.6	14.0	27.5	22.7	23.4	19.2
Neutral	12.2	22.8	12.5	15.9	12.5	25.0
Agree	51.2	47.4	52.5	45.5	56.3	28.8
Strongly agree	14.6	10.5	5.0	4.5	6.3	11.5
Total (N)	41	57	40	44	64	52
Mean	3.51	3.44	3.30	3.09	3.42	3.02
SD	1.14	1.03	1.02	1.16	.97	1.26
Statement 1.6b Helps to perform better audit						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	12.5	7.3	7.5	13.6	1.5	15.4
Disagree	20.0	10.9	40.0	27.3	38.5	26.9
Neutral	20.0	25.5	15.0	31.8	12.3	26.9
Agree	40.0	45.5	32.5	25.0	41.5	23.1
Strongly agree	7.5	10.9	5.0	2.3	6.2	7.7
Total (N)	40	55	40	44	65	52
Mean	3.10	3.42	2.88	2.75	3.12	2.81
SD	1.19	1.07	1.11	1.06	1.05	1.19
Statement 1.6c Improves auditor's recommendations						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	7.3	3.5	5.0	11.4	1.5	10.0
Disagree	12.2	12.3	22.5	20.5	16.9	20.0
Neutral	7.3	14.0	20.0	13.6	13.8	14.0
Agree	56.1	57.9	42.5	50.0	53.8	36.0
Strongly agree	17.1	12.3	10.0	4.5	13.8	20.0
Total (N)	41	57	40	44	65	50
Mean	3.63	3.63	3.30	3.16	3.62	3.36
SD	1.14	.98	1.09	1.16	.98	1.29
Statement 1.6e Reduces audit fees						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	14.6	8.9	5.0	7.0	12.3	11.5
Disagree	46.3	57.1	27.5	32.6	38.5	32.7
Neutral	26.8	23.2	45.0	44.2	24.6	17.3
Agree	9.8	5.4	20.0	16.3	20.0	30.8
Strongly agree	2.4	5.4	2.5	0	4.6	7.7
Total (N)	41	56	40	43	65	52
Mean	2.39	2.41	2.88	2.70	2.66	2.90
SD	.96	.93	.88	.83	1.08	1.19
Overall Mean	3.16	3.20	3.09	2.91	3.21	3.03
Overall SD	.7957	.6408	.7173	.7792	.7055	.9192

The loan officer, financial analyst, and academic categories scored lower frequencies than the auditor and the financial director participants. The users of the financial statements are the individuals who may experience adverse consequences from the misrepresentation of financial statements, thus, they have negative views on the relationship between the provision of NAS and audit quality. The academics disagreed (42.3%) with the statement regarding the positive effect of NAS on audit quality. This unsupportive attitude to audit enhancement through NAS could reflect the opinion that auditors should produce high quality audits without such assistance.

Statement 1.6c is that auditor recommendations to the client are improved through NAS provision. The majority of categories and participants agreed with this statement, with differences in frequencies and means. The highest means, 3.63 for the academics and both auditor categories; 73.2 per cent of the major auditor group agreed with the statement. These results are consistent with those of the third statement: a greater understating of the client's business increases the ability of the auditor to improve recommendations and support findings of Thornton, Reinstein, and Miller (2003).

The last statement (1.6e) refers to lower audit fees with additional NAS. The economies of scope when an auditor provides both audit and NAS to a client is claimed to produce cost-savings for both auditors and clients (Arruñada, 1999a). However, low audit fees may be used to procure clients who then give lucrative non-audit business to the external auditor. Studies have proved the contrary, finding a positive relation between fees from audit and non-audit services (e.g., Simunic, 1984; Palmrose, 1986; Firth, 1997a).

Table 7.14 Statement 1.6e, audit fees shows the frequency distributions of the perceptions of the respondents regarding whether the provision of NAS lower audit fees. The majority of categories and participants disagreed with this statement; therefore, audit fees are not affected by the provision of NAS. The auditors' responses showed the highest frequency, and 60.9 per cent of the major auditors and 66 per cent of the auditors from smaller firms disagreed with the statement. For the user groups, 32.5 per cent and 39.9 per cent of the loan officers and the financial analysts disagreed; however, there was a high abstention rate for both user groups (45% and 44.2% respectively recorded neutral views). The majority of the academic group disagreed (44.2%).

These results indicate that the majority of all respondents perceived the audit fees were not affected by NAS provision. These results are consistent with Simunic (1984) who, in early research, found that audit fees of clients who also purchased NAS from their auditors are significantly higher than audit fees of clients who did not do so. This study was later repeated by researchers using samples from diverse countries, who found a positive relationship between audit fees and NAS fees (e.g., Turpen, 1990; Barkess & Simnett, 1994; Firth, 1997a).

7.4.4 Disadvantages of Prohibiting NAS for Auditors

This section discusses the proposition that NAS is not provided by auditors, as is the case in Saudi Arabia. It was argued at s7.4.3 that the auditor's knowledge of the client's financial affairs enhances an audit opinion. Moreover, external auditors contracted to a client over a period have audit experience with the company and are in a strong position to give NAS advice (Canning & Gwilliam, 1999). However the concept of audit risk, and the subsequent articulation of audit risk by the ISAB (s3.4) gives voice to the perception of audit risk by the users of financial statements. Auditors using the audit risk model are in a position to decide the level of risk to which the client is exposed through the quality of its financial statements, and set the audit fee accordingly (Houston, Peters & Pratt, 1999). This allows the client-auditor contract to be fulfilled; however, without comment in the audit report, this arrangement lacks transparency for users of the financial statements.

In this study, a number of issues related to the provision of NAS were investigated to measure the disadvantages of banning the NAS for audit clients. Table 7.15 Disadvantages of Prohibiting NAS by Auditors illustrates these issues through respondents' views.

The first issue of table 7.15, Statement 1.7a, investigates whether banning the provision of NAS for the audit client reduces auditors' knowledge regarding their clients. The majority of categories disagreed with this statement. The greatest disagreement was evinced by the academics (73%) and the lowest percentage was recorded by the major auditor group (51.2%). For the user groups (the loan officers and the financial analysts), similar proportions disagreed, 61.6 per cent and 61.3 per cent respectively.

The second statement, 1.7b, is that banning NAS to audit clients may reduce audit quality. The majority of all groups disagreed, that is, banning NAS will not reduce the quality of the audit. The smaller auditor firms offered emphatic denial (96.5%) and the lower result, the financial analyst group, comprised nearly three-quarters of responses in denial (70.4%). When comparing these results with those in Table 7.14, banning NAS provision has no effect on the quality of audit; however, allowing NAS provision may increase the quality of audit.

Table 7.15:
Disadvantages of Prohibiting NAS by Auditors

Statement 1.7a Reduces auditors' knowledge regarding their clients

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	14.6	17.5	2.6	13.6	15.4	19.2
Disagree	36.6	59.6	59.0	47.7	56.9	53.8
Neutral	19.5	12.3	12.8	15.9	10.8	7.7
Agree	29.3	8.8	23.1	22.7	15.4	13.5
Strongly agree	0	1.8	2.6	0	1.5	5.8
Total (N)	41	57	39	44	65	52
Mean	2.63	2.18	2.64	2.48	2.31	2.33
SD	1.07	0.89	0.96	1.00	0.97	1.12

Statement 1.7b Reduces audit quality

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	31.7	21.1	7.5	22.7	21.9	19.6
Disagree	39.0	75.4	80.0	47.7	56.3	62.7
Neutral	19.5	3.5	5.0	18.2	15.6	11.8
Agree	4.9	0	7.5	11.4	3.1	3.9
Strongly agree	4.9	0	0	0	3.1	2.0
Total (N)	41	57	40	44	64	51
Mean	2.12	1.82	2.13	2.18	2.09	2.06
SD	1.08	0.47	0.65	0.92	0.89	0.81

Statement 1.7c Negatively impacts the audit profession

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	22.0	22.8	7.5	29.5	29.2	35.3
Disagree	48.8	68.4	70.0	47.7	50.8	51.0
Neutral	19.5	1.8	12.5	11.4	7.7	7.8
Agree	4.9	5.3	10.0	11.4	7.7	2.0
Strongly agree	4.9	1.8	0	0	4.6	3.9
Total (N)	41	57	40	44	65	51
Mean	2.22	1.95	2.25	2.05	2.08	1.88
SD	1.01	0.79	0.74	0.94	1.05	0.93

Statement 1.7e Increases audit fees

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	14.6	7.0	5.0	0	10.8	3.8
Disagree	24.4	45.6	35.0	25.0	32.3	30.8
Neutral	46.3	26.3	45.0	59.1	30.8	32.7
Agree	12.2	17.5	15.0	15.9	23.1	21.2
Strongly agree	2.4	3.5	0	0	3.1	11.5
Total (N)	41	57	40	44	65	52
Mean	2.63	2.65	2.70	2.91	2.75	3.06
SD	0.97	0.97	0.79	0.64	1.03	1.07
Overall Mean	2.40	2.15	2.43	2.40	2.32	2.30
Overall SD	0.72	0.40	0.53	0.66	0.67	0.62

The third issue (Statement 1.7c) is the effect on the audit profession. In Saudi Arabia, it is common for smaller, local accounting and auditing firms to offer consulting services, thus the ban on NAS provision to their clients by auditors may reduce the number of available audit professionals in the country. The analysis on this issue shows the majority disagreed to a deleterious effect in banning NAS on the audit profession, with small auditors at a low of 70.8 per cent disagreement, and major auditors at a high of 91.2 per cent.

The final issue in table 7.15, Statement 1.7e, refers to a hypothetical banning of NAS leading to an increase in audit fees. As discussed in s7.4.3 (Advantages of Auditors Providing NAS), respondents' groups perceive that providing NAS to an audit client does not reduce the audit fee. In this section, the proposition that banning NAS for auditors leads to an increase in audit fees is explored.

Major auditors disagreed that the ban on NAS inflates audit fees (39%) although nearly half (46.3%) elected a neutral response, whilst a majority of the smaller auditors, 52.6 per cent disagreed. Loan officers and financial analysts disagreed (40% and 25%, respectively), although there were high neutral responses, 45% for loan officers and 59.1 per cent for the financial analysts. For the financial director group, 43.10% disagreed, while the academic group were divided. The variations, including the several high non-responses, evinced by the categories may reflect the auditing environment in Saudi Arabia. Because of the hypothetical nature of NAS provision in the Kingdom, decisions on exploratory situations emanating from NAS produce conflicting evidence.

7.4.5 Safeguarding Auditor Independence

Auditor independence perceptions are formed in an environment subject to continuous change. Policymakers require vigilance to identify and assess emerging risks and employ regulatory safeguards to maintain a fair trading environment. In this study, a number of safeguards for auditor impartiality were investigated. These procedures concern the auditing profession, the audit firm, and those relating to the audit clients.

NAS Prohibition NAS to audit clients is prohibited in Saudi Arabia because of the inherent risk to auditor independence. Restricting audit firms' consultancy activities (NAS) assists their objectivity through a mandated focus on the audit only; however, NAS should not be the only means of ensuring auditor objectivity. Moreover, it is argued that a total prohibition on NAS for audit clients weakens audit firms' overall technical expertise and undermines audit effectiveness (Riesenberg, 2002).

Table 7.16 Prohibition of NAS to Audit Clients considers whether audit firms should be prohibited from providing NAS to their audit clients.

Table 7.16
Prohibition of NAS to Audit Clients

Statement 6.1 Audit firms should be prohibited from providing NAS to their audit clients

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	7.3	25.0	2.5	4.5	13.8	11.5
Disagree	31.7	41.1	45.0	31.8	36.9	25.0
Neutral	17.1	8.9	12.5	9.1	13.8	9.6
Agree	14.6	19.6	30.0	27.3	21.5	30.8
Strongly agree	29.3	5.4	10.0	27.3	13.8	23.1
Total (N)	41	56	40	44	65	52
Mean	3.27	2.39	3.00	3.41	2.85	3.29
SD	1.38	1.22	1.13	1.32	1.30	1.38

The majority of the major auditors in table 7.16 agreed that auditors should be prevented from offering NAS to their clients (43.9%); however, there was a relatively large abstention (17.1%). In an expected response, a two-thirds majority of smaller auditing firms' participants disagreed (66.1%). These results are consistent with those in table 7.13, where a thin majority of major auditors were against providing NAS to audit clients, while smaller auditors approved NAS for audit clients. This is explained by commercial reality for the smaller firms of generally larger fees from NAS than audits. Hudaib (2003), in a prior study of auditor independence in Saudi Arabia, states that auditors consider that they are the most proficient providers of NAS to their clients. Moreover, a small audit firm representative understands the nature of their clients' businesses and has the client's trust.

The users of the financial statements were divided on NAS prohibition; as credit providers, 47.5 per cent of the loan officers disagreed with prohibition, and as investors, 54.6 per cent of the financial analysts agreed with prohibition. The mean for the loan officer group is 3 and for the financial analyst group is 3.41. These mixed results indicate that the loan officer group has little issue with auditors providing NAS for their audit clients while the financial analysts have an opposing perspective.

As producers of financial statements, the majority of the financial directors disagreed with prohibition of NAS for audit clients (50.7%). This result is consistent with that of table 7.13, where more than 50 per cent of the financial directors agreed with auditors providing

NAS to their audit clients. However, this outcome has the potential to affect the relationship between auditor and client, which may risk auditor independence.

As an independent group with no direct stake in financial statements, a majority of academics agreed with prohibition of NAS to audit clients (at statement 6.1, table 7.16; 53%). Yet a similar majority of academics (at statement 1.2, table 7.13; 52%) agreed with the provision of NAS to audit clients. This mixed result may reflect differences in the questions; statement 6.1 (table 7.16) *Audit firms should be prohibited from providing NAS to their audit clients*, and statement 1.2 (table 7.13), *Auditors should be legally allowed to provide NAS for their audit clients*. In the first statement 1.2, arguably viewed by participants as concerning individuals, the academics drew upon their Saudi knowledge and confirmed NAS were acceptable. Conceivably, this was due to the lack of Saudi auditors and the emerging need for accountants and auditors in the changing private sector environment as Saudi Arabia moves toward a mixed economy. To academics, audit firms (statement 6.1 and table 7.16) represent international conglomerates, which, in retrospect, offer a varied accounting environment at best. Trust is not high for expatriates in the Saudi environment.

Supplementary Disclosure More disclosure can enhance auditor independence and as a result enhance audit quality. Lennox (1999) investigated the effect of NAS on audit quality and the author found that when non-audit fees are disclosed, NAS do not reduce audit quality. Disclosing audit and non-audit fees increases auditor independence. Hillison and Kennelley (1988) suggested that audit firms should be allowed either to provide certain NAS for audit clients or provide all types of NAS but require full disclosure. Thus full disclosure is a safeguard to mitigate certain threats to auditor independence.

Table 7.17
Supplementary Disclosure

Statement 6.2 NAS fees to auditors should be disclosed by public companies						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	4.9	0	0	0	1.5	0
Disagree	12.2	12.5	7.5	6.8	12.3	9.6
Neutral	14.6	23.2	2.5	9.1	4.6	7.7
Agree	39.0	46.4	70.0	54.5	52.3	42.3
Strongly agree	29.3	17.9	20.0	29.5	29.2	40.4
Total (N)	41	56	40	44	65	52
Mean	3.76	3.70	4.03	4.07	3.95	4.13
SD	1.157	.913	.733	.818	.991	.929

Table 7.17 Supplementary Disclosure (cont.)

Statement 6.3 NAS fees to non-auditors should be disclosed by public companies

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	2.4	0	2.5	2.3	6.2	1.9
Disagree	29.3	25.0	22.5	13.6	33.8	15.4
Neutral	22.0	25.0	10.0	9.1	13.8	15.4
Agree	31.7	41.1	57.5	47.7	30.8	42.3
Strongly agree	14.6	8.9	7.5	27.3	15.4	25.0
Total (N)	41	56	40	44	65	52
Mean	3.27	3.34	3.45	3.84	3.15	3.73
SD	1.119	.959	1.011	1.055	1.228	1.069

Statement 6.4 Audit fees should be disclosed by public companies

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	12.5	3.6	0	0	4.6	.0
Disagree	12.5	30.4	12.5	6.8	23.1	9.6
Neutral	25.0	25.0	10.0	4.5	6.2	5.8
Agree	30.0	21.4	57.5	59.1	44.6	48.1
Strongly agree	20.0	19.6	20.0	29.5	21.5	36.5
Total (N)	40	56	40	44	65	52
Mean	3.33	3.23	3.85	4.11	3.55	4.12
SD	1.289	1.191	.893	.784	1.199	.900

Statement 6.5 Disclosure of audit and NAS fees strengthens auditor independence

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	7.3	0	0	0	7.7	0
Disagree	24.4	28.6	15.0	9.1	10.8	7.7
Neutral	26.8	35.7	12.5	18.2	26.2	21.2
Agree	31.7	23.2	50.0	50.0	35.4	42.3
Strongly agree	9.8	12.5	22.5	22.7	20.0	28.8
Total (N)	41	56	40	44	65	52
Mean	3.12	3.20	3.80	3.86	3.49	3.92
SD	1.122	.999	.966	.878	1.161	.904

Statement 6.6 The nature of NAS should be disclosed in annual financial statements

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	12.2	0	0	2.3	3.1	0
Disagree	17.1	44.6	10.0	6.8	18.5	2.0
Neutral	17.1	12.5	10.0	13.6	12.3	2.0
Agree	41.5	35.7	62.5	56.8	46.2	52.9
Strongly agree	12.2	7.1	17.5	20.5	20.0	43.1
Total (N)	41	56	40	44	65	51
Mean	3.24	3.05	3.88	3.86	3.62	4.37
SD	1.241	1.052	.822	.905	1.100	.631
Overall Mean	3.33	3.30	3.80	3.95	3.55	4.05
Overall SD	0.88	0.74	0.62	0.67	0.83	0.64

Table 7.17 shows the stakeholders' perceptions regarding supplementary disclosure issues, found to enhance auditor independence. The overall means of all stakeholders are greater than 3. The first issue analysed is disclosure of NAS fees paid to auditors by public companies. Participants were asked their views regarding whether public companies should be required to disclose all non-audit fees paid to their external auditors. The majority of each group agreed with the statement. The loan officer group had the highest percentage (90%) and the major auditor group the lowest, at 64.3 per cent. These results are consistent with the results obtained by authors such as Hartley and Ross (1972), and Schleifer and Shockley (1990). They found that financial statement users prefer full disclosure of NAS fees paid to the external auditor.

The second issue relates to fees paid to NAS providers other than a public company's external auditors. The majority of each group approved the disclosure of NAS fees to other non-audit providers; however, the percentages were lower. The financial analyst group (75%) offered the strongest views on the topic, and the financial director group's percentage (46.2%) was the weakest.

The third disclosure issue is the need to disclose audit fees. The stakeholders' groups were asked to provide their perceptions regarding whether audit clients should be required to disclose their audit fees. Table 7.17 shows that both major and smaller auditors had the lowest rate (50% and 41%, respectively), while the financial analyst and academic categories the highest rate (88.6% and 84.6%, respectively). For the loan officers, 77.5 per cent agreed with the statement. This suggests that the users of the financial statements, represented by the loan officers and the financial analysts, prefer greater disclosure of financial information in regards to audit and NAS fees.

The fourth statement in this section examines whether disclosing audit and NAS fees strengthens auditor independence. The results show that the majority of each category answered in the positive; however, the proportion of participants in each group were substantially different. The users (loan officers and financial analysts) and the academics strongly supported the statement (72.5%, 72.7% and 71.1%, respectively); however, the auditors were less committed (41.5% and 35.7%, respectively). These results show that disclosure of audit and NAS fees is perceived to strengthen auditor independence. The lesser support by the auditors indicates that the auditors' professional integrity assures auditor independence.

The last issue of supplementary disclosure is whether the financial report should include the nature and the type of all NAS services provided by the external auditor. The results show that, with the exception of the major auditors, the majority of each stakeholder's groups supported this statement. The academics and the user groups (loan officer and financial analyst categories) showed the highest support (96%, 80% and 77.3%, respectively), and the major auditors had the lowest majority (53.7%). These results show that the users of the financial statements demand further disclosures of the nature and the type of NAS, which is consistent with the result obtained by Hartley and Ross (1972).

The findings of this section are that the majority of stakeholders support the notion of greater disclosure. Disclosing audit and NAS fees thereby strengthens auditor independence. Moreover, disclosing the nature of the NAS in the annual report also enhances auditor independence. These disclosure requirements are evidence of safeguards to auditor independence, an alternative to the ban on NAS.

Auditor Employment with Client Of the various auditor-client relationships, the client employment of ex-auditors can be perceived as impairing auditor independence. The opinions of the six stakeholder groups are analysed to find the outcomes to an auditor-client relationship when an ex-member of an auditor is employed by a current client of that auditor. Two variables were examined: prohibiting auditors from providing executive recruiting service for their audit client, and prohibiting clients from offering a job to their external auditors.

Table 7.18 shows the results of the two issues related to employment with the audit client.

The first issue is whether audit firms should be prohibited from offering formal, paid executive recruiting services to their audit clients, and the second issue is whether public companies should not offer a job to their external auditors or their personnel. Providing such services by the external auditor can weaken the independence of the external auditor due to the relationship that occurs between the executive and the external auditor.

Table 7.18
Employment with an Audit Client

Statement 6.10 Audit firms should be prohibited from offering formal, paid executive recruiting services to their audit clients						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	4.9	1.8	0	0	4.6	0
Disagree	22.0	36.4	32.5	20.9	23.1	8.0
Neutral	34.1	34.5	25.0	25.6	16.9	10.0
Agree	22.0	16.4	35.0	25.6	33.8	40.0
Strongly agree	17.1	10.9	7.5	27.9	21.5	42.0
Total (N)	41	55	40	43	65	50
Mean	3.24	2.98	3.18	3.60	3.45	4.16
SD	1.14	1.03	0.99	1.12	1.20	0.91
Statement 6.14 Public companies should not offer a job to their external auditors or their personnel						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	12.5	5.5	5.0	2.4	6.2	3.9
Disagree	22.5	14.5	25.0	7.3	16.9	5.9
Neutral	22.5	23.6	22.5	22.0	21.5	5.9
Agree	20.0	36.4	25.0	43.9	36.9	35.3
Strongly agree	22.5	20.0	22.5	24.4	18.5	49.0
Total (N)	40	55	40	41	65	51
Mean	3.18	3.51	3.35	3.80	3.45	4.20
SD	1.36	1.14	1.23	0.99	1.16	1.06
Overall Mean	3.21	3.28	3.26	3.7	3.45	4.21
Overall SD	1.06	0.70	0.90	0.89	0.99	0.75

Table 7.18, Statement 6.10, illustrates the results of the stakeholders' perceptions regarding the offer by auditors of recruitment services for clients. The majority of the major auditors (39.1%) supported the statement while the majority of the minor auditors (38.2%) did not. The majority of both user groups agreed with the statement (42.5% and 53.5%, respectively), and the financial directors also support the statement (55.3%). For the academics, 82 per cent agreed, the strongest response of the participant categories.

It was expected that the majority of the auditors would not agree with such statement due to the advantage that may be gained by auditors when providing paid recruitment services to their audit clients. Prohibiting auditors from providing such service may reduce their NAS fees, which may affect their competitive position. However, the academic group, an independent group, strongly supported the prohibition of recruitment services, suggesting such action may enhance auditor independence.

The second issue is whether audit clients should be banned from offering jobs for their external auditors. It is believed that employment of a firm's auditors by a client may impair auditor independence (e.g., Imhoff, 1987; Koh & Mahathevan, 1993). Executives are found to be affiliated with their companies' audit firms if they previously worked for those audit firms (Lennox, 2005). The following section of the table shows the opinion of all stakeholder groups regarding whether audit firms should be banned from offering jobs to their external auditor or its personnel. With the exception of the major auditors, the results are close to the prior results in this section. The academic group are critical regarding audit-client employment relationship (84.3%), while the minor auditors changed their opinion when it came to a client hiring an external auditor (56.4%).

Outsourcing Internal Audit Organisations tend to outsource their internal audit functions to avoid extra cost when performing such service internally (e.g., Martin and Lavine, 2000, Carey, Subramaniam, & Ching 2006) or to get access to specialised internal auditors to ensure a high quality of service (Selim and Yiannakas, 2000). CPA firms view internal audit activities as an expanding service for both new and existing clients and many of these CPA firms create their own business units to market and deliver internal audit outsourcing services. It is believed that the effect of the provision of NAS on auditor independence depends on the type of service provided to the audit client (Goldwasser & Morris, 2002). The US SEC banned nine types of NAS, including internal audit outsourcing by the external auditor, asserting that the provision of such services by the external auditor may impair auditor independence. The issue of internal audit outsourcing and the manner by which it affects auditor independence is investigated in the auditing literature (e.g., Lowe & Pany, 1999; Selim & Yiannakas, 2000).

Table 7.19 Internal audit outsourcing: Risk to Auditor Independence presents the stakeholders' perceptions of auditor independence when the internal audit function is outsourced.

The independent variable (internal audit outsourcing) was manipulated at three levels. The results regarding the investigation of the first level are presented in the first part, which is when the external auditor with no staff separation performed the internal audit function of the audit client.

Table 7.19
Internal Audit Outsourcing: Risk to Auditor Independence

Statement 6.11b The company's external auditors, same personnel, perform the internal audit function						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	4.9	1.8	7.5	4.5	9.2	10.0
Disagree	29.3	32.7	20.0	29.5	16.9	20.0
Neutral	7.3	16.4	15.0	13.6	12.3	12.0
Agree	29.3	34.5	50.0	36.4	38.5	38.0
Strongly agree	29.3	14.5	7.5	15.9	23.1	20.0
Total (N)	41	55	40	44	65	50
Mean	3.49	3.27	3.30	3.30	3.49	3.38
SD	1.33	1.13	1.11	1.19	1.28	1.29
Statement 6.11c The company's external auditor, different personnel, perform the internal function						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	9.8	1.8	5.0	0	10.9	8.3
Disagree	26.8	41.1	42.5	34.9	12.5	31.3
Neutral	22.0	23.2	30.0	27.9	20.3	22.9
Agree	24.4	28.6	17.5	25.6	39.1	31.3
Strongly agree	17.1	5.4	5.0	11.6	17.2	6.3
Total (N)	41	56	40	43	64	48
Mean	3.12	2.95	2.75	3.14	3.39	2.96
SD	1.27	1.00	0.99	1.04	1.23	1.11
Statement 6.11d Internal audit function is outsourced to another external auditor						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	24.4	8.9	10.0	9.3	15.4	15.7
Disagree	41.5	51.8	62.5	48.8	44.6	49.0
Neutral	9.8	19.6	15.0	20.9	15.4	11.8
Agree	24.4	17.9	7.5	14.0	13.8	19.6
Strongly agree	0	1.8	5.0	7.0	10.8	3.9
Total (N)	41	56	40	43	65	51
Mean	3.12	2.95	2.75	3.14	3.39	2.96
SD	1.11	0.95	0.95	1.07	1.22	1.10

In general, the results show that the majority of all stakeholder groups agreed with the first statement, which is that auditor independence will be at risk if the external auditor with no staff separation performs the internal audit function. The financial director's group recorded the highest percentage (61.6%), while the major auditor's group (49%) recorded the lowest percentage. However, four categories (both auditor groups, financial analysts and academics) recorded percentages 30% and above disagreeing with the statement, which indicates that some individuals view that performing the internal audit function by the external auditor does not weaken auditor independence.

The second level is when the external auditor, but different personnel, performed the internal audit function. The results of this level show that some of the stakeholders' groups changed their perceptions regarding the effect on auditor independence compare to the situation at the first level. The majority of three stakeholder's groups, namely: major auditors; financial analysts; and financial directors, agreed with the statement scoring 56.3 per cent, 41.5 per cent and 37.2 per cent, respectively, while the majority of the other three groups, namely: minor auditors; loan officers; and academics did not. This means that the majority of the smaller auditors, the loan officers and the academics perceived independence enhanced when there is a separation of staff within the audit firm.

The third level is when an audit firm other than the company's external auditor performed the internal audit function. Stakeholders' groups recognised the differences between this situation and the first two situations and generally disagreed with statement. The majority of each stakeholder group disagreed with the statement indicating that firm separation can be employed to safeguard auditor independence. The results in Table 7.19 (first and third statements) indicate that stakeholders' perceptions of auditor independence are greater when the internal audit function was outsourced to an audit firm other than the firm that performs the external audit than when the same audit firm performs both jobs.

In summary, a number of stakeholder groups (the smaller auditors; the loan officers and the academics) recognised the importance of the staff separation as a safeguard to enhance auditor independence. This result suggests that a system of safeguards that incorporate clear separation of staff would serve the public interest without resorting to the total prohibition against audit firms providing internal audit functions for their audit clients. Weak corporate governance, prohibiting only the company's external auditor from the internal audit function, may lead to weak internal control systems for companies.

Audit Committee and NAS In recent corporate governance reforms in the US (Sarbanes-Oxley Act of 2002), audit committees were required to pre-approve audit and NAS provided to the audit client to ensure that they do not impair auditor independence. Previous studies revealed that the presence of an active audit committee enhances auditor independence (e.g., Sori & Karbhari, 2006). In this study, audit committee pre-approval of NAS provided by the external auditor was considered as one of the safeguarding factors that enhance auditor independence. Stakeholder's groups were asked to indicate their perceptions regarding whether audit committee must per-approve all permitted NAS provided by the external auditor. Table 7.20 Audit Committee Prior Approval of NAS shows the results regarding this issue.

The majority of all stakeholders' groups supported the statement. These results suggest that prior approval of NAS by the audit committee is a safeguard for auditor independence. It enhances the credibility of the financial statements by enhancing auditor independence.

Table 7.20
Audit Committee Prior Approval of NAS

Statement 6.7 Audit committee must approve all permitted NAS to be provided by the external auditor before the services is provided

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	5.1	0	0	0	1.5	0
Disagree	10.3	14.5	5.0	9.3	7.7	8.3
Neutral	5.1	16.4	5.0	9.3	1.5	2.1
Agree	48.7	61.8	67.5	60.5	58.5	50.0
Strongly agree	30.8	7.3	22.5	20.9	30.8	39.6
Total (N)	39	55	40	43	65	48
Mean	3.90	3.62	4.08	3.93	4.09	4.21
SD	1.12	0.83	0.69	0.83	0.88	0.85

Policy Auditor independence is a vital quality control element that Saudi audit firms must implement. According to the Quality Control Standards for Accounting Offices, issued by the SOCPA, audit firms and offices in Saudi Arabia must develop appropriate polices and procedures to provide a reasonable degree of confidence regarding the independence of their auditors and personnel. Some of these policies are:

- Allocating a specific person to give advice and take action on all matters related to independence.
- Informing all auditors and personnel about the policies and procedures on independence and update them regularly.
- Emphasise the importance of independence and its requirements during training sessions and also during the process of audit.
- Informing audit partners and personnel about the audit firm's clients and any related parties regularly.

These policies and procedures can be used as safeguards to enhance auditor independence.

Table 7.21 Independence Policies presents the results of the manner by which stakeholders groups perceive the importance of such procedures that can be used to maintain independence.

Table 7.21
Independence Policies

Statement 6.12 Audit firms should have certain procedures and suitable measures to maintain their independence						
Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	2.4	0	0	2.3	3.1	2.0
Disagree	4.9	1.8	2.5	4.5	1.6	3.9
Neutral	2.4	8.9	2.5	6.8	6.3	2.0
Agree	29.3	48.2	67.5	56.8	60.9	43.1
Strongly agree	61.0	41.1	27.5	29.5	28.1	49.0
Total (N)	41	56	40	44	64	51
Mean	4.41	4.29	4.20	4.07	4.09	4.33
SD	0.95	0.71	0.61	0.87	0.83	0.86

The results show that all stakeholders' groups strongly supported the statement. The majority of all groups agreed with the statement. These results suggest that audit firms should have policies and procedures in place to ensure the independence of firm members. Thus, having a strong quality control system within the audit firm enhances stakeholders' perceptions regarding auditor independence. Of interest is a minor percentage (average 10%) of all groups, including 5.9 percent of academics, who demurred. A neutral or even negative response to this question transgresses Saudi legislation, and strong international statements and trade agreements. This raises the question of an alternative, perhaps enforceable auditor independence system that is the responsibility of a single agency. Saudi financial matters are managed through SOCPA, SAMA and the Ministry of Commerce and this situation, together with the religious and secular legal systems, weakens singular agency control. A single entity responsible for monitoring auditor independence may arguably have been the dissidents' preference.

Selection of External Auditors Organisation rules governing the hiring and the firing of auditors influence auditor independence. Previous studies find that transferring the power to hire and fire the auditor from managers to investors significantly decreases the proportion of independence violations (Mayhew & Pike, 2004). This finding plays a role in enhancing auditor independence. The stakeholders' perceptions regarding whether investors' selection of auditors enhance auditor independence were investigated. Table 7.22 Investor Selection and Auditor Independence shows the results of the stakeholders' perception regarding this issue.

Table 7.22
Investor Selection and Auditor Independence

Statement 6.13 Investor selection of auditors enhances auditor independence

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Strongly disagree	4.9	1.8	5.0	2.3	3.1	3.9
Disagree	14.6	12.7	17.5	16.3	4.6	15.7
Neutral	22.0	10.9	25.0	18.6	15.4	7.8
Agree	34.1	52.7	35.0	51.2	43.1	21.6
Strongly agree	24.4	21.8	17.5	11.6	33.8	51.0
Total (N)	41	55	40	43	65	51
Mean	3.59	3.80	3.43	3.53	4.00	4.00
SD	1.16	0.99	1.13	0.98	0.98	1.27

The majority of all groups supported the statement. This suggests that investors should be allowed to hire and fire the auditor of their company to enhance auditor independence. These results are consistent with the results obtained by Mayhew and Pike (2004). To enhance auditor independence, the authors suggest that investors or other non-managers should be given more power by law over the hiring and firing of auditors.

7.5 Summary

In this chapter, the descriptive analyses of this study were presented. The first section of analysis is related to the demographic information of the participants. The participants were divided into six groups, namely: major auditors; minor auditing firms; loan officers; financial analysts; financial directors; and academics. Table 7.2 shows the response rate where 580 questionnaires were distributed and 299 were returned, a response rate of 52 per cent.

A number of demographic variables were then analysed by obtaining the frequency distribution and the tendency measures for each variable. These variables are: gender; age; level of education; experience; number of accounting courses taken by the respondents; professional qualifications; country of final qualification; and level of interest in this study. Each variable is expected to have some implication on the participants' perceptions regarding the issues under investigation.

The relationship between NAS provision for audit clients and auditor independence was then investigated. Four issues were discussed. The first issue measured the participants' views regarding auditor independence. The results indicate a general understanding of the importance of auditors to be independent when auditing clients. This stems from the prohibition of the auditor to provide tax and zakat services to their audit clients until 1998, when SOCPA issued Rules permitting such provision in response to the dearth of national auditors and the preponderance of international financial services firms (s2.8.2). The major audit firms controlled 66 per cent of the Saudi financial services market (with Arthur Andersen and Whinney Murray capturing about 41% of the total market partly due to their long presence in the country) while the smaller fims serviced the remainder (Hudaib, 2003).

The second issue was to investigate stakeholders' views on NAS provision on auditor independence. Two statements were used to gauge perceptions regarding the NAS issue. It was interesting to find that the majority of the major firm auditors disagreed with auditors providing NAS for their audit clients, whilst accepting that auditors can maintain their independence while providing NAS for their audit clients. The other interesting finding was that the majority of the financial analysts and half of the loan officers supported the notion of allowing auditors to provide NAS for their audit clients; on the other hand, they reported that auditors cannot maintain their independence whilst doing so. These results indicate that users of the financial statements were not against NAS provision for audit clients; however, auditors required policy parameters to promote impartiality. Importantly, providing tax and zakat service to the audit client makes the auditor unique to that client. This was illustrated on the world audit environment by the Enron/Andersen affair, where Fearnley and Beattie (2004) stated that the principal relationship between an Andersen partner, and the unique relationship between a single Andersen office and the Enron corporation arguably triggered the audit failure. This raised widespread belief that the auditor had compromised its independence as auditors (s3.4.3). In Saudia Arabia, auditors may also act as advocates, defending their clients' position against the Department of Zakat and Income Tax. Further, Hudaib (2003), in a Saudi study, found that the practice of NAS services, other than tax and zakat services, was still widespread in Saudi Arabia despite the prohibition, due to a lack of qualified auditors. This further weakens the perception of independence of auditors by the major stakeholders of audited financial statements.

The third issue investigated was the possible advantages to Saudi Arabia and similar countries that restrain NAS for their auditing firms. The results indicate that both auditors' categories views on the issue were that providing NAS to audit clients has a complementary effect on both NAS and audits through deeper knowledge of the firm's business. However, auditors reported that audit fees are not affected by the provision or non-provision of NAS. The users' groups (loan officers and financial analysts) have opposed views regarding whether NAS provision enhances audits. Although the majority of users reported that NAS provision assists auditors to understand their clients, auditors have a professional obligation to their clients with or without NAS. The users' group think that auditors should be sufficiently professional to undertake a quality audit.

The fourth issue concerned disadvantages to auditor impartiality when NAS was prohibited. The majority of participants and categories reported that disallowing NAS provision should not affect auditors' knowledge about audit clients, audit quality, the audit profession, and audit fees. Prohibition of NAS has no negative effect; however, allowing NAS provision may have a positive effect, as discussed in the previous paragraph.

Next, seven factors to safeguard to auditor independence were considered. The first factor was a total ban to NAS provision for audit clients. Three categories (smaller local auditor firms, loan officers, and financial directors) disagreed that a total ban on NAS provision was effective to auditor independence, while the remaining groups (major auditors, financial analysts, and academics support such action. The second factor was the disclosure of audit and NAS fees and reporting the nature of NAS in the annual financial statements. The majority of all stakeholders' groups are interested in greater disclosure to audit and NAS fees, especially regarding NAS paid to the external auditor. The third factor was the relationship with the audit client when recruitment was involved. Two issues related to this factor were investigated, first, the formal paid executive recruiting service to audit clients; and second, audit clients offering jobs for their auditors and their personnel. For the first issue, with the exception of major auditors, all participant categories supported this action. For the second issue, the majority of participants and categories supported the action of banning audit clients from offering jobs to their auditor's staff. This aspect encompasses two distinct issues; audit firms providing NAS through executive search services; and the separate issue of the governance for auditors being encouraged (by the auditor firm) or enticed (by the audit client) into employment for the client. For the major auditors, providing recruiting services is different from moving to work with the audit client. On the first point, there are NAS issues of fees; on the second issue there are probity issues. These points could be the focus of further research.

The fourth factor is related to separation of staff or firm would enhance auditor independence, in this case, internal audit. The results indicate that a majority of stakeholders viewed the internal audit function as NAS without separation of staff might weaken auditor independence. When applying staff separation as a safeguard, only three groups (major auditors, loan officers, and academics) agreed that such action would enhance auditor independence. However, when applying firm separation as a safeguard, all groups agreed that such action would enhance auditor independence.

The fifth factor that might be applied to enhance auditor independence is the audit committee prior approval of NAS. The results show that all groups agreed that pre-approving NAS strengthens auditor independence. The sixth and the seventh factors that were examined to identify enhancements to auditor independence are not related to the provision of NAS. Implementing an effective quality control system within the audit firm and switching the power to engage auditors from managers to investors may enhance auditor independence. The results indicate that all groups agreed that both factors strengthen auditor independence.

In this study, the findings are that stakeholder's groups differ in their perceptions of policies that effectively improve auditor independence. Surprisingly, independence itself is often not the issue. A more knowledgeable audit committee and an effective quality control system improve the accountability of management to their stakeholders without a total ban against audit firms providing non-audit services.

These findings are made within the context of both religious and secular legislation, as Saudi Arabia is an Islamic state. The Kingdom differs to other Gulf countries as it has a specific entity, the Saudi Organisation for Certified Public Accountants (SOCPA), dedicated inter alia to reviewing, developing and approving auditing standards. Nevertheless, these findings are relevant to GCC countries due to a convergence in their status as emerging economies. Further, the findings add to world knowledge, as the structure of this thesis is based on the literature and its findings were designed to be comparable with extant and future research that follows audit research protocols.

Given the events of the last decade, governance by world authorities and professional entities of corporations' hybrid management and accounting activities has reached a crisis. Not only the perception of auditor independence is under threat, stakeholders' confidence in assessing and costing corporate risk has all but evaporated. This is arguably a factor in the audit process; that auditors' judgements are increasingly perceived by stakeholders as unreliable.

This perception of real or potential unreliability is critical to governance. Study participants differ in their assessment of the Saudi protocols necessary to promote stakeholder confidence and stabilise markets, particularly resource markets, This study is therefore a microcosm of a study which could be undertaken in any other country with similar results: stakeholders generally believe that the audit protocols and enforcement in place is sufficient to continue to invest. This is the basis of the study, and its relevance.

Chapter 8 Data Analysis: Inferential Analysis

8.1 Introduction

The previous chapter concerned analysis of the study's descriptive data regarding the demographic characteristics of the participants. It also analysed various issues relating to the provision of non-audit services (NAS) and the relationship with auditor independence. The purpose of those analyses was to show the basic features of the data through descriptive measures such as frequency distributions, cross-tabulation, means, and standard deviation.

The study's analyses extend beyond this preparatory work. In this chapter, confirmatory data analyses are presented to cover inferences regarding the phenomena for which the sample data were obtained (Weiss, 2005). This chapter is divided into two sections, the first presents the hypotheses testing procedures and results, whilst the second concerns the statistical analyses for testing the conceptual framework adopted in the study. Each stakeholder category‘s perceptions of risks, or threats, to auditor independence are analysed, and any significant differentiation between these groups are identified. Further, stakeholder groups' perceptions of each type of threat are analysed, and whether they are significantly different in their perceptions regarding each type of threat determined.

8.2 Hypotheses Testing

Testing a hypothesis is an important aspect of inferential analyses. In this study, a theory was developed in chapter 5 regarding the phenomenon of auditor independence in Saudi Arabia, where the joint provision of audit and NAS is banned. The issue of NAS and its impact on auditor independence in Saudi Arabia has not been investigated in depth (Hudaib, 2003).

Hypothesis testing is used in research to draw conclusions on matters such as whether effects actually occurred, treatments have effect, groups differ from each other, or one variable predicts another (Kerlinger & Lee, 2000). Hypothesis-testing methodology uses sample data to determine whether a null hypothesis is true. Confidence in rejecting or not rejecting the null hypothesis depends on the alpha level (α), the level of significance or the probability of rejecting the true hypothesis (Gujarati, 1995). Alpha levels chosen in research are usually 1 per cent or 5 per cent, or arguably at 10 per cent. In this study, a 5per cent significance level was chosen, thus there is a 5 per cent chance of incorrectly rejecting the null hypothesis.

In statistics, rejecting the null hypothesis when it is true means that a Type I error is committed, which is the probability of rejecting the true hypothesis; however, not rejecting the null hypothesis when it is false means that a Type II error is committed, which is the probability of accepting the false hypothesis. This means that trying to reduce the probability of rejecting the true hypothesis increases the probability of accepting the false hypothesis, so it is a trade-off between these two types of errors, given the sample size (Gujarati, 1995).

There are appropriate statistical tests for testing hypotheses. Based on the sample population and the type of data, parametric or non-parametric statistical tests are usually employed. The parametric test requires data drawn from normally distributed populations. Because the distribution of values in the sample population for this study is not known, a non-parametric test is used. This choice was influenced by prior studies that also used non-parametric tests for testing such hypotheses (e.g., Clark-Carter, 1997; Canning & Gwilliam, 1999; Joshi, Bremser, Hemalatha, & Al-Mudhaki, 2007; Quick & Rasmussen, 2005).

The non-parametric test has two assumptions both met by this research: that the observations are independent, and the variable under study has underlying continuity. Thus, non-parametric statistical tests are used in this study to draw inferential conclusions regarding the data collected. Further, the test of K-independent samples using the Kruskal-Wallis Test is used to check for significant differences between the participant categories, while the Mann-Whitney Test is used to check for significant differences between two categories to locate such differences.

In this study, participants were asked to indicate their level of agreement with the statement provided using a response scale of 5 levels, where the value of 1 represents ‘strongly disagree’; 2 represents ‘disagree’; 3 represents ‘natural’; 4 represents ‘agree’ and 5 represents ‘strongly agree’. The answers ‘strongly disagree’ and ‘disagree’ as well as ‘strongly agree’ and ‘agree’ are summed up in each case to facilitate analysis.

8.2.1 Attitude to Auditor Independence

The homogeneity of participants’ views regarding auditor independence is essential to the research, as participants were chosen due to their knowledge of the subject (sophisticated users). Participants were asked their level of agreement regarding the importance of auditor independence (Appendix I, statement 1.1). Table 8.1 Attitudes to Auditor Independence shows the answers in percentages and the number of participants in each group.

Table 8.1
Attitudes to Auditor Independence

Category Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	0	1.8	7.5	9.1	3.1	1.9
Neutral	2.4	1.8	0	0	3.1	1.9
Agree	97.6	96.5	92.5	90.9	93.9	96.2
N	41	57	40	44	65	52

The results of table 8.1 show that all participant groups view auditor independence in auditing as important, especially the major auditors (97.6%), for whom the concept is critical to their integrity and thus their professional reputations. Financial analysts, although very supportive, perhaps give less consideration to the principle.

To test for differences among the categories on the participants' views on auditor independence, it was hypothesised that stakeholder groups differ in their perceptions regarding auditor independence, thus the first null hypothesis is stated.

$H_0$1: There is no consensus among study categories' perceptions of auditor independence

A non-parametric test of K-independent samples using the Kruskal-Wallis Test was conducted. Table 8.2 Differences of Category Views on Auditor Independence illustrates the results.

Table 8.2
Differences of Category Views on Auditor Independence

Part A Category	N	Mean Rank
Major Firm Auditors	41	150.29
Minor Firm Auditors	57	146.18
Loan Officers	40	144.04
Financial Analysts	44	143.49
Financial Directors	65	154.00
Academics	52	159.06
Total (N)	299	
Part B		Test Statistics[a,b]
Chi-Square		2.472
Df		5
Asymp. Sig.		.781

a Kruskal Wallis Test
b Group Variable: q3

Table 8.2, Part 1 shows the mean rank of the categories, and Part 2 shows the result of testing $H_0 1$, that the significance value is greater than .05 ($p = .781 > .05$ level), which means that there is no significant difference among stakeholder categories' views on auditor independence, thus, $H_0 1$ is rejected. All stakeholder groups are similarly aware of the importance of the independent auditor. This result satisfies the sophisticated user participants' assumption made when identifying the participant groups (s6.3.4). A comparison of the categories' means in part A finds that the academic group has the highest result (159), with the financial analyst group reporting the lowest (143).

8.2.2 Attitudes to Auditor Independence When NAS Provided

Based on the literature review at chapter 3, the majority of studies on auditor independence regarding the joint provision of NAS and audits were conducted in environments where the joint provision is permitted. This study is conducted in Saudi Arabia where the joint provision of audit and NAS is banned. Issues examined were whether auditors should be allowed to provide NAS for their audit clients, and whether auditors' independence can be maintained under these conditions. Results obtained in this section are used to answer the first research question (s5.4.2).

Allowing Auditors to Provide NAS for their Audit Clients Saudi Arabia prohibits auditors from providing NAS to audit clients, as the government's perception is that auditors cannot be independent under these conditions. In this Saudi study, participants were asked their views on auditor-provided NAS. Table 8.3 Provision of NAS by Auditors shows the analysis of their responses.

Table 8.3
Legalise Provision of NAS by Auditors

Category Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	52.5	23.6	45.0	54.5	40.0	33.4
Neutral	7.5	7.3	10.0	13.6	9.2	13.7
Agree	40.0	69.1	45.0	31.9	50.8	52.9
Total (N)	40	55	40	44	65	51

The majority of the minor firm auditors (69.1%), financial directors (50.8%), and academics (52.9%) agreed that auditors should be legally permitted to provide NAS for their audit clients, while the majority of the major auditors (52.5%) and the financial analysts (54.5%) disagreed. The loan officer group was split with a fairly high abstention rate (10%).

In this Table 8.3 analysis, participant categories differ in opinion, explained by the stakeholders' varying interests in the financial statements. Thus, the second null hypothesis is stated.

$H_0$2: Participant categories' views do not differ on legalising NAS provision by Saudi auditors to their audit clients

To test this hypothesis for groups' differences, the non-parametric test, Kruskal-Wallis Test, is used and Table 8.4 Category Differences Regarding Legalising Saudi NAS provision shows the results.

When examining the means for the categories in Table 8.4, Part A, a major difference occurs between the auditors' means for major (172.71) and minor firm (123.18) representatives. This finding is discussed shortly. The results in Table 8.4, Part B, indicate that the difference in the mean ranks of the stakeholder groups is not significant at 5 per cent ($p = .064 > .05$), although it is significant at 10 per cent. Thus, the second null hypothesis is rejected at $\alpha = 0.1$. It is concluded that participant categories differ in their views on legalising NAS for Saudi auditor clients.

Table 8.4
Category Differences Regarding Legalising Saudi NAS provision

Part A Category	N	Mean Rank
Major Firm Auditors	40	140.41
Minor Firm Auditors	55	172.71
Loan Officers	40	136.40
Financial Analysts	44	123.18
Financial Directors	65	153.80
Academics	51	150.42
Total (N)	295	
Part B		**Test Statistics[a,b]**
Chi-Square		10.421
df		5
Asymp. Sig.		.064

a Kruskal Wallis Test
b Group Variable: q3

The phenomena of auditor categories substantially differing in their views on a research question is subject to further analysis. In this situation, the Mann-Whitney Test is used for multiple comparisons between two groups at a time to show which of the groups are significantly different. Table 8.5 Significance of Group Differences on NAS Provision (Mann-Whitney Test) shows the result of the multiple comparisons.

Table 8.5
Significance of Group Differences on NAS Provision (Mann-Whitney Test)

Participant Categories	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.056	.928	.379	.500	.584
Minor Firm Auditors		--	.013*	.002*	.311	.170
Loan Officers			--	.357	.315	.392
Financial Analysts				--	.092	.114
Financial Directors					--	.783
Academics						--

* Significant difference at $\alpha = 0.05$

An interesting result from the Mann-Whitney Test is obtained. While testing the differences between categories at one time did not reveal significant difference at the .05 level, significant results were obtained when testing for difference between two-independent groups at a time. The results in Table 8.5 show that the major auditors' perception is significantly different from the loan officers' and the financial analysts' perceptions regarding whether to allow auditors to provide NAS for their audit clients. For these three groups, $H_0 2$ has to be rejected at $\alpha = .05$.

Maintaining Auditor Independence The second issue relating to the effect of NAS on auditor independence is the ability of auditors to maintain their independence in this situation. Based on the literature review at chapter 4, there was no consensus among researchers on the effect of NAS provision on auditor independence, and controversy over the provision of NAS continues. In this study, participants were asked their opinions on whether auditors can maintain their independence while providing NAS for their audit clients. Table 8.6 Attitudes on Maintenance of Auditor Independence shows the aggregated results.

Table 8.6
Attitudes on Maintenance of Auditor Independence

Category Response	Major Firm Auditors Percentage	Minor Firm Auditors Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	36.60	17.50	42.50	47.80	30.80	36.50
Neutral	12.20	7.10	20.00	18.20	16.90	19.20
Agree	51.20	75.40	37.50	34.00	52.30	44.30
Total (N)	41	57	40	44	65	52

The majority of four stakeholder categories (major auditors, minor firm auditors, financial directors, and academics) reported that auditors can maintain their independence, while the majority of the other two groups (loan officers and financial analysts) disagreed.

This statement was used to test the third null hypothesis, which examines whether stakeholder groups differ in their perceptions regarding auditors' ability to maintain their independence when performing NAS for their audit clients.

$H_0$3: Participant categories do not differ in their perceptions regarding auditor independence when NAS is provided for audit clients

In Table 8.7, Category Differences Regarding Perceptions of Independence, Part A shows the mean rank for each stakeholder group and Part B shows the result of testing the differences among stakeholder groups' perceptions.

Table 8.7 Part A shows that the mean rank for the minor firm auditors is the highest (183.62) while the financial analyst category is again the lowest (122.93). Thus, the minor firm auditors report the strongest result, that auditor independence with NAS can be maintained. This finding is discussed later. The result at Part B indicates that there is a significant difference ($p = .003 < .05$), between the groups regarding auditors' abilities to maintain their independence when performing NAS for their audit clients, thus, $H_0$3 is rejected.

Table 8.7
Category Differences Regarding Perceptions of Independence

Part A Category	N	Mean Rank
Major Firm Auditors	41	152.21
Minor Firm Auditors	57	183.62
Loan Officers	40	134.76
Financial Analysts	44	122.39
Financial Directors	65	159.15
Academics	52	135.05
Total	299	

Part B	Test Statistics[a,b]	
Chi-Square		18.049
df		5
Asymp. Sig.		.003

a Kruskal Wallis Test
b Group Variable: q3

To identify where mean rank differences occur, the Mann-Whitney Test was conducted for multiple comparisons at Table 8.8 Significance of Group Differences on Maintenance of Independence (Mann-Whitney Test).

Table 8.8
Significance of Group Differences on Maintenance of Independence (Mann-Whitney Test)

Participant Categories	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.070	.379	.112	.681	.329
Minor Firm Auditors		--	.002*	.000*	.142	.001*
Loan Officers			--	.436	.164	.993
Financial Analysts				--	.033*	.462
Financial Directors					--	.136
Academics						--

* Significant difference at α = 0.05

Table 8.8 shows that significant difference occurs first between minor firm auditors and loan officers; second, minor firm auditors and financial analysts; third, minor firm auditors and academics; and finally, financial analysts and financial directors. No significant differences can be found between the major firm auditors' group and all other groups, and for these results, $H_0 3$ is not rejected.

8.2.3 Audit Quality

In this study it is argued that the provision of NAS for audit clients improve audit quality (Arruñada, 1999a). Despite the concern regarding the negative effect of NAS on auditor independence, there is an argument that states that the provision of NAS may have a net positive effect on audit quality (Lennox, 1999). To explore perceptions regarding the positive effect of NAS on audit quality (second research question s5.4.3), participants were asked whether the provision of NAS: assists auditors to understand their clients better; is conducive to a better audit; and improves auditors' recommendations to improve their clients' operational effectiveness. Table 8.9 NAS Enhances Audit Quality shows the aggregated results for the three statements (Appendix I, statements 1.6a, 1.6b, and 1.6c) after they are combined.

Table 8.9
NAS Enhances Audit Quality

Category / Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	25.00	16.36	40.00	34.09	25.00	34.00
Neutral	5.00	14.55	5.00	9.09	7.81	12.00
Agree	70.00	69.09	55.00	56.82	67.19	54.00
N	40	55	40	44	64	50

The majority of all groups agreed with statements relating to enhancement of auditor quality through provision of NAS. However, the percentages differ among the categories, thus there are differing opinions from the groups.

Research suggests that the provision of NAS increases the technical competence of auditors; thus, NAS are an important source of information for professional decisions (Arruñada, 1999a). However, other research suggests that auditors should be competent and not to rely on NAS to understand their audit clients. Hence, the null hypothesis regarding audit quality is:

$H_0$4 Participant categories do not differ in their perceptions regarding the effect of NAS provision on audit quality

Table 8.10 Category Differences Regarding NAS Provision and Audit Quality shows the results of this analysis.

Table 8.10 Category Differences Regarding NAS Provision and Audit Quality

Part A Category	N	Mean Rank
Major Firm Auditors	40	163.93
Minor Firm Auditors	55	163.58
Loan Officers	40	137.18
Financial Analysts	44	124.85
Financial Directors	64	154.95
Academics	50	132.39
Total	293	
Part B	**Test Statistics[a,b]**	
Chi-Square	9.569	
df	5	
Asymp. Sig.	.088	

a Kruskal Wallis Test
b Group Variable: q3

Part A of table 10 shows the mean rank for the six participant categories. The major and minor firm auditor groups have the highest overall ranking (163.93 and 163.58, respectively), while the financial analyst group has the lowest (124.85). This indicates that the two auditor groups have higher positive views on the effect of the joint provision of NAS and audits on audit quality. To test the differences between the categories, a non-parametric test, Kruskal-Wallis, was conducted. The results at table 10 part B show that the difference between categories is not significant at 5 per cent level ($p = .088 > .05$), thus failing to reject $H_0$4; however, it is significant at the 10 per cent level.

Although the result of testing the differences between categories was not significant at the 5 per cent level, a test of significance was conducted for all groups. Table 8.11

Significance of Group Differences on NAS Provision and Audit Quality Maintenance (Mann-Whitney Test) shows the results.

Table 8.11
Significance of Group Differences on NAS Provision and Audit Quality Maintenance (Mann-Whitney Test)

Participant Categories	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.929	.162	.037*	.514	.102
Minor Firm Auditors		--	.115	.024*	.499	.069
Loan Officers			--	.460	.244	.709
Financial Analysts				--	.052	.733
Financial Directors					--	.147
Academics						--

* Significant difference at $\alpha = 0.05$

The results at Table 8.11 illustrate the slight significant differences that exist between the major firm auditors and the financial analysts ($p = .037 <.05$) and between the minor firm auditors and the financial analysts' group ($p = .024 < 05$) and for these results, $H_0 4$ should be rejected.

8.2.4 Enhancing Auditor Independence

Different procedures can be employed to enhance the perception of auditor independence when NAS is provided; however, participant categories views may vary regarding these procedures. These procedures may be generally applied, such as prohibiting NAS for audit clients, or be specifically applied such as prohibiting certain NAS that are viewed as a greater risk to auditor independence. In this section, the stakeholders' perceptions regarding a number of procedures are examined to observe whether the categories differ in their views. Results obtained in this section are used to answer the third research question (s5.4.4).

Prohibiting NAS_Regulators in countries where NAS are prohibited argue that such provision impairs auditor independence and the most effective response is to ban the joint provision of audit and non-audit services to the same client (Pearson, 1985). Those regulators assume that users of financial statements are adamant that external auditors should be free from any management influence. Saudi Arabia prohibits joint provision of audit and NAS to maintain auditor independence and a high quality of audit. Hudaib (2003, p. 230) reports a comment from a member of the Saudi Organisation for Certified Public Accountants (SOCPA) regarding this issue:

> Well, we prohibit provision of consultancy services by the incumbent auditor to reduce the risk that auditor would not be independent and perform high audit quality … we do not pay attention to the argument which says that the auditor is the best person to provide consultancy services to his audit client … however, we are aware that the provision of auditing and MAS services by incumbent auditors is still widespread in the Kingdom despite the prohibition.

It appears that the regulatory authorities in Saudi Arabia believe that the joint provision of audit and non-audit services affects auditor independence negatively, affecting audit quality. The official stance is not consistent with the results of this study where the majority of all participant categories reported a positive effect of the joint provision of NAS and audit upon audit quality.

Participants were asked their views whether auditors should be prohibited from providing NAS for their audit clients. Table 8.12 Auditors Prohibited from NAS Provision shows the results.

Results presented at table 8.12 indicate differences in the participant groups' responses. The majority of the major firm auditors, loan officers, and financial directors' categories reject the Saudi ban of NAS for audit clients, while the majority of the other three groups support the prohibition.

Table 8.12
Auditors Prohibited from NAS Provision

Category Response	Major Firm Auditors Percentage	Minor Firm Auditors Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	39.00	66.10	47.50	36.30	50.75	36.50
Neutral	17.10	8.90	12.50	9.10	13.85	9.60
Agree	43.90	25.00	40.00	54.60	35.40	53.90
Total (N)	41	56	40	44	65	52

As stakeholder groups, displaying their differing interests, have varied opinions on supporting a total ban of the joint provision, the fifth null hypothesis is stated.

$H_0$5: Stakeholders' group do not differ in their perceptions regarding a total ban of NAS provision for audit clients

Table 8.13 Category Differences Regarding NAS Prohibition presents the analysis for this hypothesis.

Table 8.13 *Category Differences Regarding NAS Prohibition*

Part A Category	N	Mean Rank
Major Firm Auditors	41	166.83
Minor Firm Auditors	56	110.79
Loan Officers	40	150.35
Financial Analysts	44	175.05
Financial Directors	65	140.04
Academics	52	167.08
Total	298	
Part B	**Test Statistics[a,b]**	
Chi-Square		21.168
Df		5
Asymp. Sig.		.001

a Kruskal Wallis Test
b Group Variable: q3

The mean ranks, in part A of table 8.13 show that the financial analysts, agreeing with the statement, returned the highest mean, while the minor firm auditors had the lowest mean. For the user groups, the loan officers had a higher mean than the financial analysts, indicating that the financial analysts (investors) are more concerned about auditor independence than loan officers (creditors). Part B shows the results of testing the significance of the differences between the categories, that a significant difference exists among stakeholder groups (p = .001 <.05), thus the hypothesis is rejected.

The Mann-Whitney Test was applied to determine the significance of these differences. The results are shown in Table 8.14 Significance of Group Differences on NAS Prohibition for Auditors (Mann-Whitney Test).

Table 8.14
Significance of Group Differences on NAS Prohibition for Auditors (Mann-Whitney Test)

Participant Category	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.001*	.335	.689	.113	1.00
Minor Firm Auditors		--	.010*	.000*	.048*	.001*
Loan Officers			--	.127	.490	.264
Financial Analysts				--	.031*	.654
Financial Directors					--	.082
Academics						--

* Significant difference at α = 0.05

It appears in table 8.14 that the views of the minor firm auditors are significantly different from all other groups, and the p-value of the financial analysts and the financial directors significantly differ from each other (p = .031 <.05). These results show that minor firm auditors support the notion of permitting auditors to provide NAS for their audit clients. The minor firm auditors are thus consistent with the results obtained by Hudaib (2003), that the majority of small firm auditors view NAS positively for auditor independence. However, for the major firm auditors, the results show that the majority agreed with prohibition of NAS for auditors.

Separation of Personnel Performing NAS_Instead of prohibiting all NAS, Arruñada (1999a) argues that the use of separate divisions and separate personnel for NAS by auditors working with clients may safeguard auditor independence. Further, empirical studies find that the threat to auditor independence decreases when there is a separation of personnel performing NAS and audits for clients (e.g., Pany & Reckers, 1984; Lowe & Pany, 1995; Lowe, Geiger, & Pany, 1999). In this study, participant groups were asked their opinions whether auditors should be allowed to provide NAS for their audit clients only if there is separation of staff. Table 8.15 NAS Provision Based on Separation of Personnel shows the results.

Table 8.15
NAS Provision Based on Separation of Personnel

Statement 1.5 Auditors should be allowed to provide NAS for their audit clients ***only if*** *the personnel involved are not working with the audit team.*

Participant Category	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	41.46	28.07	45.00	44.19	33.85	34.62
Neutral	19.51	15.79	12.50	20.93	20.00	15.38
Agree	39.02	56.14	42.50	34.88	46.15	50.00
Total (N)	40	55	40	44	65	51

The findings at table 8.15 are that the majority of three participant categories agreed that separation of personnel in joint services to audit clients enhances auditor impartiality (small firm auditors, financial directors, and academics), while the majority of the other groups (major firm auditors, loan officers, and financial analysts) disagreed with the statement. Comparing these results with those at s8.2.4 on prohibition of NAS, there were no real differences in the views expressed except for the academics. The academic category agreed on prohibition of NAS; however, if NAS was permitted and when a separation of staff was employed, they agreed with allowing NAS provision.

A test of significant differences was conducted for the following null hypothesis, **$H_0$6: Categories differ in their views whether to allow NAS provision only if there is separation of personnel performing the NAS**

Table 8.16, Category Differences Regarding Separation of Personnel for NAS and Audit Part A, shows the mean ranks for all stakeholder groups.

Table 8.16
Category Differences Regarding Separation of Personnel for NAS and Audit

Part A Category	N	Mean Rank
Major Firm Auditors	41	140.44
Minor Firm Auditors	57	161.31
Loan Officers	40	151.71
Financial Analysts	43	135.90
Financial Directors	65	151.18
Academics	52	151.15
Total	**298**	
Part B	Test Statistics[a,b]	
Chi-Square	2.829	
Df	5	
Asymp. Sig.	.726	

a Kruskal Wallis Test
b Group Variable: q3

The minor firm auditors have the highest mean rank while the financial analysts presented the lowest. Part B shows the result of testing the significance of differences between categories. There is no significant difference between categories mean results ($p = .726 > .05$), therefore $H_0$6 is rejected and participant categories' opinions do not differ on whether to allow auditors to provide NAS with separation of staff.

Supplementary Disclosure Supplementary disclosures of audit and NAS fees for incumbent and non-incumbent auditors and a management report showing the nature of other services provided by the external auditor can be used as procedures to enhance auditor independence. These procedures may be implemented by the audit profession or regulators to enhance auditor independence. Many countries require their registered companies to disclose audit and NAS fees paid to their auditors. Lennox (1999, p 241) argues that *when fees are undisclosed, there may be greater scope for implicit collusion or 'auditor-manager side-contracting', whereby managers provide auditors with financial incentives to give favourable* *reports*. Thus, disclosing audit and NAS fees gives investors and other stakeholders more insight into the relationship between auditors and their audit clients.

In this study, participant groups were asked their views regarding six statements (Appendix I, statements 6-2 to 6-7) relating to the effect of supplementary disclosure on auditor independence. Table 8.17 NAS Provision Based on Supplementary Disclosure of Fees shows the results.

Table 8.17
NAS Provision Based on Supplementary Disclosure of Fees

Category Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	35.00	39.29	10.00	9.09	21.54	5.88
Neutral	2.50	5.36	5.00	.0	6.15	3.92
Agree	62.50	55.36	85.00	90.91	72.31	90.20
Total (N)	40	56	40	44	65	51

Table 8.17 shows that the category majorities agreed with these statements. The two auditor groups were less committed, possibly because such information made available on fee structures may give companies commercial information that could be used to negotiate favourable prices for services from other providers (Francis & Wang, 2004). Thus, the null hypothesis is stated as follows.

$H_0$7: Participant categories do not differ in their views on the effect of supplementary disclosure of fee structures on auditor independence

A test of significance was conducted for $H_0$7 to determine whether stakeholder categories differ in their views regarding the supplementary disclosure of audit and NAS fees. Table 8.18, Category Differences Regarding Supplementary Disclosure for NAS and Audit Fees presents the results.

The highest means ranking in table 8.18, part A is the academic category, followed by financial analysts and loans officers. This result is understandable, as users of the financial statements are more concerned about auditor independence due to their reliance on the financial statements. Auditor categories and financial directors returned low means, which indicates that these stakeholders consider that supplementary disclosure has a lesser effect on auditor independence. Part B results exhibit significant difference across the categories regarding the effect of the supplementary disclosure on auditor independence ($p = .000 < .05$), which means that $H_0$7 is rejected.

Table 8.18

Category Differences Regarding Supplementary Disclosure for NAS and Audit Fees

Part A Category	N	Mean Rank
Major Firm Auditors	40	114.79
Minor Firm Auditors	56	105.37
Loan Officers	40	164.65
Financial Analysts	44	181.69
Financial Directors	65	140.02
Academics	51	191.81
Total	296	

Part B	Test Statistics[a,b]
Chi-Square	42.652
Df	5
Asymp. Sig.	0

a Kruskal Wallis Test
b Group Variable: q3

When group differences were examined in pairs in order to identify where exactly the differences are, results vary as shown in Table 8.19 Significance of Group Differences on Supplementary Disclosure of NAS and Audit Fees (Mann-Whitney Test).

Table 8.19

Significance of Group Differences on Supplementary Disclosure of NAS and Audit Fees (Mann-Whitney Test)

Participant Category	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.692	.006 *	.000*	.154	.000*
Minor Firm Auditors		--	.000*	.000*	.029*	.000*
Loan Officers			--	.261	.161	.072
Financial Analysts				--	.013*	.491
Financial Directors					--	.001*
Academics						--

* Significant difference at α = 0.05

The auditors' categories, particularly the minor firm group, differ significantly from other groups. The major firm auditors significantly differ from the two user groups and the academic group. Further, no differences can be found among the two user groups and the academic group.

Employment with Audit Clients The issue of employment with audit clients is recognised as a risk to auditor independence (Lennox, 2005). In the case of a member of an external auditor's firm accepting a position with the firm's client, a relationship between that individual and the former employer may compromise the quality of a future audit of the client by that firm. In fact, audit quality may be affected even before the individual leaves the audit firm if in employment negotiations with the audit client. The United States' *Sarbanes-Oxley Act 2002*, a determinant for global audit propriety, requires a one-year cooling-off period before a certified practising accountant may take up an executive position with an audit client after leaving an external auditor firm (Lennox, 2005)

In this study, stakeholder groups were asked their views regarding two statements related to the employment with audit clients. These two statements (6-10 and 6-14 in the questionnaire, Appendix I) are:

- Audit firms should be prohibited from offering formal, paid executive recruiting services to their audit clients
- Public companies should not offer a job to their external auditors or their personnel

Table 8.20 Auditors Providing Recruitment Services for Clients presents the frequency percentages after combining these two statements.

Table 8.20
Auditors Providing Recruitment Services for Clients

Category Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	27.50	12.96	30.00	14.63	24.62	8.00
Neutral	30.00	50.00	20.00	19.51	12.31	2.00
Agree	42.50	37.04	50.00	65.85	63.08	90.00
Total (N)	40	56	40	44	65	51

The results of table 8.20 show that, with the exception of the minor firm auditors, the category majorities agreed with these two statements; however, these percentages differ. For the minor firm auditors, 50 per cent were undecided, as indeed 30 per cent of the major firm auditors were also neutral. This indicates that auditors have less incentive to support such action than other stakeholder categories because this action may reduce the career opportunities available to them. Thus, there are differences among stakeholders' regarding the issue of employment and the eighth null hypothesis is stated.

$H_0$8: Participant categories do not differ in their views on the effect of employment with audit clients on auditor independence

A test of significance was conducted for $H_0$8. Table 8.21 Category Differences Regarding Auditor Employment and Recruitment Services presents these results.

Table 8.21

Category Differences Regarding Auditor Employment and Recruitment Services

Part A Category	N	Mean Rank
Major Firm Auditors	40	120.65
Minor Firm Auditors	54	118.45
Loan Officers	40	121.96
Financial Analysts	41	160.13
Financial Directors	65	141.52
Academics	50	206.60
Total	290	

Part B	Test Statistics[a,b]
Chi-Square	41.270
df	5
Asymp. Sig.	0

a Kruskal Wallis Test
b Group Variable: q3

In part A of table 8.21, the academic category has the highest overall ranking (206.6) while the minor firm auditor group has the lowest. For the user groups, loan officers and financial analysts, the mean ranks are 121.96 and 160.13, respectively. This means that the financial analyst group has a higher perception of the effect of the employment with audit clients on auditor independence than the loan officer group. The result in Part B shows that a significant difference exists among stakeholders groups (p = .000 <.05).

The Mann-Whitney test was conducted to test for differences presented at Table 8.22 Significance of Group Differences on Auditor Recruitment or Employment Services to Clients (Mann-Whitney Test).

Table 8.22

Significance of Group Differences on Auditor Recruitment or Employment Services to Clients (Mann-Whitney Test)

Participant Categories	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.836	.861	.036*	.211	.000*
Minor Firm Auditors		--	.950	.009*	.101	.000*
Loan Officers			--	.036*	.247	.000*
Financial Analysts				--	.244	.005*
Financial Directors					--	.000*
Academics						--

* Significant difference at α = 0.05

Table 8.22 shows that the academics are significantly different from all other categories, and the financial analysts are significantly different from all other groups, except financial directors. There should be no conflict of interest between academics and any other stakeholder category in terms of using the financial statements, so the difference between academics and all other groups is significant. There is a common benefit between financial directors and the two auditor categories when it comes to allowing employment with audit clients. The auditors will have better opportunities to further their careers through taking up positions with their audit clients and, at the same time, audit clients (financial directors) have opportunities to employ highly experienced people. Financial analysts recognised the potential effect of allowing employment with audit clients on the independence of the auditor, and as a result the effect on the quality of audit; thus, they exhibited significant opinion regarding the issue.

8.2.5 Hypothesis Testing for Auditor Independence

The empirical findings on the perceptions of stakeholder categories on the effect of the joint provision of audit and NAS on auditor independence are presented at s8.2.2, s8.2.3, and s8.2.4. A number of issues relating to the relationship between NAS provision and auditor independence are investigated and discussed. The Kruskal-Wallis Test was conducted to examine whether the categories significantly differ in their views on these issues, the Mann-Whitney Test was also used to locate these differences.

Findings show that the views and opinions of stakeholder categories on matters influencing auditor independence do not significantly differ. The findings of this study are that stakeholders in auditor independence strongly endorse the concept in a range of conditions and situations.

The effect of NAS on auditor independence was tested. First, findings show that the minor firm auditors and the financial directors were strongly supportive of NAS provision for audit clients, while the users' groups (loan officers and financial analysts) were against such action. Significant differences exist between categories at $\alpha = 0.1$. The significant difference exists between the groups of minor firm auditors and loan officers, and also between minor firm auditors and financial analysts. Thus, minor firm auditors strongly support allowing auditors to provide NAS for their audit clients; on the other hand, the two groups of users were strongly against the proposition. This result is explained through the next issue where the user groups consider that auditors are not able to maintain their independence when providing NAS for their audit clients; thus, the joint provision should be banned. Further, findings also suggest that the user groups view audit quality as remaining robust with the provision of NAS, because auditors should have the ability to perform high quality audits. Minor firm auditors report that audit quality can be improved if auditors perform NAS for their audit clients.

Factors enhancing auditor independence were also tested. The prohibition of auditors providing NAS for their audit clients is examined. Findings show that financial analysts and academics were the most supportive groups to prohibition of auditors from NAS, while the minor firm auditors and the financial directors disagreed, so the minor firm auditors' perception is significantly different from all other groups However, with the issue of separation of audit and NAS personnel for the client, the difference is not significant, which indicates that such separation of personnel for the client can be used as an effective safeguard to auditor independence.

The potential improvement of auditor independence through supplementary disclosure of NAS and audit fees and related NAS information was tested. The majority of all categories agreed with this suggestion, with significant differences between categories. Except for no significant difference between major firm auditors and financial directors, the opinions of auditor categories are significantly different from all others. Financial directors' opinions are significantly different from the views of financial analysts and academics. This indicates that auditors and audit clients show weak support for disclosure while academics and users strongly support the disclosure of fees and information related to NAS provision.

The last issue is related to potential employment of auditor staff with clients and whether prohibiting such action enhances auditor independence. The views of the two auditor categories significantly differ from financial analysts and the academics. Further, academics show significant difference from all other categories. This implies that the academic group has the highest level of opinion on employment while the two auditor groups have the lowest, thus auditors are aware of losing employment opportunities with their audit clients.

8.3 Threats to Auditor Independence

The US Independence Standards Board (ISB) (2000) identifies five types of threats or risks to auditor independence: self-interest, self-review, advocacy, familiarity, and intimidation (s5.3). The first four can occur through the provision of NAS to audit clients

(Fearnley & Beattie, 2004). Shaub (2004) suggested potential auditor independence measures, adopted for the purposes of this research, to address the first four threats to independence.

Measures of auditor self-interest include NAS fees as a percentage of total fees and an auditor's total revenue, overdue audit and NAS fees owed by a client, and client power over auditors. NAS fees are used to illustrate the threat from self-review; provision of tax and zakat services and fees, and assisting in the decision-making process with audit clients describe potential for the risk of advocacy. The type of relationships created between the auditor and the client and the auditor providing recruitment services for the client were used to measure the familiarity threat.

The original set of statements (Appendix I) in each type of threat was reduced using Cronbach's alpha. Table 8.23 Variables and Cronbach's alpha for Each Item and Group describes this analysis.

Table 8.23
Variables and Cronbach's alpha for Each Item and Group

Variable Analysis	Self-interest		Self-review		Advocacy		Familiarity	
	Alpha	Items (N)	Alpha	Items (N)	Alpha	Items (N)	Alpha	Items (N)
Category								
Major Firm Auditors	0.93	7	0.91	9	0.81	7	0.70	7
Minor Firm Auditors	0.86	9	0.90	9	0.70	8	0.75	8
Loan Officers	0.90	6	0.90	11	0.80	9	0.76	7
Financial Analysts	0.91	7	0.88	10	0.83	8	0.82	8
Financial Directors	0.89	7	0.87	9	0.76	9	0.79	8
Academics	0.85	10	0.91	10	0.87	8	0.80	9

Research question four, (s5.4.5), looks for differences among stakeholder groups regarding types of threats to auditor independence. Therefore, the methodology selected here is to look for significant differences in two ways. First, how each stakeholder group perceives the four types of threat and whether significant differences exist among the classes of threat. Second, how stakeholder groups perceive each type of threat and whether significant differences exist among groups. One reason for not using hypothesis in this section is to reduce the number of hypotheses used in the thesis and also to differentiate it from the first section.

8.3.1 Differences among Types of threats

In this section, participant responses are examined in terms of each category's majority view on the threats, and whether significant differences exist between them regarding the four types of threats to auditor independence.

Major Firm Auditors This category is presented in Table 8.24 Major Firm Auditors Category: Type of Threat.

Table 8.24
Major Firm Auditors Category: Type of Threat

Major Firm Auditors	Self-interest Percentage	Self-review Percentage	Advocacy Percentage	Familiarity Percentage
Disagree	52.6	45.0	7.5	39.0
Neutral	42.1	30.0	32.5	48.8
Agree	5.3	25.0	60.0	12.2
Total (N)	38	40	40	41

Table 8.24 shows that 52.6 per cent and 45 per cent of major firm auditors consider that auditor independence is at risk from self-interest and self-review threats, respectively, while there is no potential advocacy threat (7.5%) and the majority of respondents were neutral for potential familiarity threat. Thus, major firm auditors are aware of two types of threats: self-interest in terms of financially dependence on audit clients, and self-review threat in terms of reviewing their own work.

Table 8.25, Major Firm Auditors: Variable Differences of Threat is the analysis of responses to determine whether major firm auditors have significant differences in their opinions regarding the major risk to auditor independence.

Table 8.25
Major Firm Auditors: Variable Differences of Threat

Part A Variable	N	Mean Rank
Self-interest	38	53.12
Self-review	40	75.00
Advocacy	40	120.05
Familiarity	41	70.72
Part B	Test Statistics[a,b]	
Chi-Square	45.441	
df	3	
Asymp. Sig.	0	

a. Kruskal Wallis Test
b. Group Variable: Threats

Part A of table 8.25 shows that self-interest has the lowest mean while the advocacy threat has the highest; therefore, the majority of major firm auditors consider that self-interest is a risk to auditor independence. Part B shows that there is significant difference in the categories' view of each threat (p = .000 < .05). To locate such significant differences, the Mann-Whitney Test for significant difference was applied between two independent groups, and results displayed at Table 8.26 Major Firm Auditors: Significance of Differences Between Threats (Mann-Whitney Test).

Table 8.26
Major Firm Auditors: Significance of Differences Between Threats (Mann-Whitney Test)

Major Firm Auditors	Self-interest	Self-review	Advocacy	Familiarity
Self-interest	--	.035*	.000*	.049*
Self-review		--	.000*	.880
Advocacy			--	.000*
Familiarity				--

* Significant difference at α = 0.05

The results show that major firm auditors considered an advocacy threat as significantly different, thus auditor independence is not threatened by factors causing advocacy threat. Self-interest is also significantly different from all other types of threat and the highest risk to auditor independence; while self-review and familiarity threats were perceived to have less effect on auditor independence and they are not significantly different from each other.

Minor Firm Auditors_Whether minor firm auditors have significantly different views regarding each threat is the focus of analyses in this sub-section. First, Table 8.27 Minor Firm Auditors Category: Type of Threats shows the percentages for all types of threat.

Table 8.27
Minor Firm Auditors Category: Type of Threat

Minor Firm Auditors	Self-interest Percentage	Self-review Percentage	Advocacy Percentage	Familiarity Percentage
Disagree	30.2	27.8	1.9	12.5
Neutral	62.3	40.7	17.3	58.9
Agree	7.5	31.5	80.8	28.6
Total (N)	53	54	52	56

In table 8.27, although 30.2 per cent of minor firm auditors saw self-interest as impacting auditor independence; 62.3 per cent were neutral. This result is consistent with the results in tables 8.3 and 8.6 where minor firm auditors agreed with allowing auditors to provide NAS for their audit clients and agreed that auditors can maintain their independence while providing NAS for their audit clients. The minor firm auditor category was not concerned (80.8%)about factors that may create an advocacy risk; they consider that assisting clients in complicated transactions or providing tax and zakat services do not affect auditor independence. The majority of this group was undecided regarding the familiarity threat; however, 28.6 per cent had little concern for a familiarity threat on auditor independence.

Table 8.28 Minor Firm Auditors: Variable Differences of Threat describes this analysis.

Table 8.28
Minor Firm Auditors: Variable Differences of Threat

Part A Variable	N	Mean Rank
Self-interest Threat	53	75.33
Self-review Threat	54	94.28
Advocacy Threat	52	164.93
Familiarity Threat	56	99.29

Part B	Test Statistics[a,b]	
Chi-Square		62.034
df		3
Asymp. Sig.		.000

a. Kruskal Wallis Test
b. Group Variable: Threats

The mean of minor firm auditors is highest for the advocacy threat and lowest for self-interest risk of auditor impartiality. Minor firm auditors consider such risk emanates from self-interest factors, while no effect is recorded for advocacy factors. Part B shows significant differences between minor firm auditors' opinions on the range of risks. Table 8.29 Minor Firm Auditors: Significance of Differences Between Threats (Mann-Whitney Test) identifies these significant differences.

Table 8.29 *Minor Firm Auditors: Significance of Differences Between Threats (Mann-Whitney Test)*

Minor Firm Auditors	Self-review	Advocacy	Familiarity
Self-interest	.175	.000*	.020*
Self-review	--	.000*	.522
Advocacy		--	.000*

* Significant difference at $\alpha = 0.05$

An advocacy threat is seen by minor firm auditors as significantly different from all other types of threat and the familiarity threat is significantly different from the self-interest threat. Self-review risk was not considered significantly different from the familiarity threat.

The difference between the auditor categories is that major firm auditors considered that self-interest threatens auditor independence, while the minor firm auditor group did not. Overall, the results obtained for auditor categories exhibit differences on the effect of the joint provision of NAS and audit services on auditor independence. While the major firm auditors saw threats from self-interest and self-review factors, the minor firm auditors considered only self-interest factors to affect auditor independence. Both groups share the views regarding advocacy threats, stating that such factors would not affect auditor independence. These results are consistent with previous studies (e.g., Beck, Frecka, & Solomon, 1988; Magee & Tseng, 1990; Lindberg & Beck, 2004) where the strength of financial dependence or economic bond between an auditor firm and its audit clients affects auditor independence.

Loan Officers This category, the first of the users of the financial statements (creditors), is expected to have different opinions regarding auditor independence, illustrated at Table Loan Officers Category: Type of Threats.

Table 8.30 *Loan Officers Category: Type of Threats*

Loan Officers	Self-interest Percentage	Self-review Percentage	Advocacy Percentage	Familiarity Percentage
Disagree	51.3	33.3	2.6	46.2
Neutral	46.2	35.9	59.0	46.2
Agree	2.5	30.8	38.4	7.6
Total (N)	39	39	39	39

Table 8.30 shows that loan officers were most concerned regarding auditor independence on NAS factors that lead to self-interest and familiarity threats (51.3% and 46.2%, respectively), while factors causing advocacy threat were perceived to have little effect on auditor independence. Table 8.31 Loan Officers: Variable Differences of Threats tests for significant difference among types of threats.

Table 8.31 *Loan Officers: Variable Differences of Threats*

Part A Variable	N	Mean Rank
Self-interest Threat	39	52.17
Self-review Threat	39	86.41
Advocacy Threat	39	113.27
Familiarity Threat	39	62.15

Part B	Test Statistics[a,b]
Chi-Square	42.768
df	3
Asymp. Sig.	0

a. Kruskal Wallis Test

b. Group Variable: Threats

Table 8.31 part A shows that Loan Officers placed advocacy threat to auditor independence with the highest mean and self-interest with the lowest mean; thus factors leading to a self-interest threat were considered a greater risk, followed by familiarity threat, and self-review of minor concern. These results were different from those of the auditor categories, where, after self-interest, risks from self-review were considered to threaten auditor independence. This indicates that auditors and creditors have different perspectives regarding auditor independence. Part B of the table shows that significant difference exists ($p = .000 < 0.05$). Table 8.32 Loan Officers: Significance of Differences Between Threats (Mann-Whitney Test) continues the analysis.

Table 8.32
Loan Officers: Significance of Differences Between Threats (Mann-Whitney Test)

Loan Officers	Self-review	Advocacy	Familiarity
Self-interest	.002*	.000*	.296
Self-review	--	.027*	.032*
Advocacy		--	.000*

* Significant difference at $\alpha = 0.05$

Table 8.32 shows that loan officers perceived self-interest threat significantly differently from self-review and advocacy, but not significantly differently from familiarity threat to auditor impartiality. Moreover, self-review and advocacy threats are perceived significantly different from all other types of threats.

Financial Analysts This category is the second group of users of the financial statements (investors), described by Table 8.33 Financial Analysts Category: Type of Threats.

Table 8.33
Financial Analysts Category: Type of Threats

Financial Analysts	Self-interest Percentage	Self-review Percentage	Advocacy Percentage	Familiarity Percentage
Disagree	50.0	42.5	16.7	46.5
Neutral	45.2	40.0	52.4	44.2
Agree	4.8	17.5	31.0	9.3
Total (N)	42	40	42	43

Table 8.33 shows that the financial analysts perceived self-interest, self-review and familiarity threats as those affecting auditor independence (50%, 42.5% and 46.5%, respectively) with high percentages for undecided participants (45.20%, 40% and 44.2%,

respectively). Advocacy, again with a high neutral response (44.2%) was considered by this category as not being a threat to auditor impartiality. Table 8.34 Financial Analysts: Variable Differences of Threats continues this discussion.

The mean ranks in table 8.34 part A shows that financial analysts view advocacy threat to auditor impartiality as the highest mean, with self-interest the lowest; thus self-interest is the greater risk, followed by familiarity and self-review threats.

Table 8.34

Financial Analysts: Variable Differences of Threats

Part A Variable	N	Mean Rank
Self-interest	42	70.50
Self-review	40	83.26
Advocacy	42	108.04
Familiarity	43	74.40
Part B		Test Statistics[a,b]
Chi-Square		15.400
df		3
Asymp. Sig.		.002

a. Kruskal Wallis Test

b. Group Variable: Threats

However, this group perceived factors that may cause advocacy threat as not affecting auditor independence. To test for significant differences among types of threats, part B shows that financial analysts perceived types of threats as significantly different (p=.002 < .05).

Table 8.35 Financial Analysts: Significance of Differences Between Threats (Mann-Whitney Test) locates such difference among threat types.

Table 8.35

Financial Analysts: Significance of Differences Between Threats (Mann-Whitney Test)

Financial Analysts	Self-review	Advocacy	Familiarity
Self-interest	.206	.001*	.637
Self-review	--	.016*	.389
Advocacy		--	.001*

* Significant difference at $\alpha = 0.05$

Table 8.35 shows that financial analysts see advocacy threat as significantly different from all other types of threats. Factors causing self-interest, familiarity, and self-review risk threaten auditor independence, while factors causing advocacy threat have no affect on auditor independence.

Financial Directors_Financial directors are identified in this study as those with direct involvement in preparation of financial statements, thus their views should differ in matters of NAS on auditor independence and this analysis begins with Table 8.36 Financial Directors Category: Type of Threats.

Table 8.36
Financial Directors Category: Type of Threats

Financial Directors	Self-interest Percentage	Self-review Percentage	Advocacy Percentage	Familiarity Percentage
Disagree	49.20	59.70	8.10	22.20
Neutral	44.40	25.80	30.60	61.90
Agree	6.40	14.50	61.30	15.90
Total (N)	63	62	62	63

Table 8.36 results are that financial directors perceive the greatest risks to auditor impartiality as self-review and self-interest threats (59.7% and 49.2% respectively). The advocacy threat was of little effect to auditor independence, while the majority were neutral regarding the effect of factors creating familiarity threat. To test whether the views of financial directors are significantly different between threats, Table 8.37 Financial Directors: Variable Differences of Threats continues the analysis.

Table 8.37
Financial Directors: Variable Differences of Threats

Part A Variable	N	Mean Rank
Self-interest	63	90.76
Self-review	62	98.21
Advocacy	62	185.50
Familiarity	63	128.05
Part B	**Test Statistics[a,b]**	
Chi-Square	66.293	
df	3	
Asymp. Sig.	0	

a. Kruskal Wallis Test

b. Group Variable: Threats

In table 8.37, part A, advocacy threat has the highest means rank while self-interest has the lowest. Part B shows that the views of this category are significantly different (p=.000 <

.05). Table 8.38 Financial Directors: Significance of Differences Between Threats (Mann-Whitney Test) finalises this category's analysis at this point.

Table 8.38
Financial Directors: Significance of Differences Between Threats (Mann-Whitney Test)

Financial Directors	Self-review	Advocacy	Familiarity
Self-interest	.539	.000*	.002*
Self-review	--	.000*	.005*
Advocacy		--	.000*

* Significant difference at $\alpha = 0.05$

Table 8.38 shows that, for financial directors, advocacy threat is significantly different from all other types of threats, and familiarity threat is significantly different from all other types of threats. This indicates that the financial director participants were not concerned about factors that may create advocacy and familiarity threats to auditor independence due to their expected views on NAS impact on auditor impartiality. Thus, financial directors may expect assistance from auditors in complex financial transactions, and view relationships with an auditor favourably without concerns of independence impairment. Accordingly, financial directors consider that auditors can participate in the preparation of a client's financial statements. However, for self-interest and self-review threats, financial directors share the general opinion of participants that these threats may create issues for auditor independence.

Academics Academics were selected as an impartial category for this research, as they are considered to have no direct involvement with the issues considered for this study. Table 8.39 Academics Category: Type of Threats presents their views.

Table 8.39
Academics Category: Type of Threats

Academics	Self-interest Percentage	Self-review Percentage	Advocacy Percentage	Familiarity Percentage
Disagree	38.80	55.50	21.60	64.70
Neutral	55.10	31.20	49.00	27.50
Agree	6.10	13.30	29.40	7.80
Total (N)	49	45	51	51

Table 8.39 shows that academics have different opinions regarding which type of threat affects auditor independence the most. The academics considered familiarity threat as the greatest risk to auditor independence, followed by self-review threat. Academics alone among the categories recognise familiarity threat, the nature of the auditor-client relationship, as the

greater of the NAS threats. The academics are less interested in other threats such as self-interest and advocacy.

Table 8.40 Academics: Variable Differences of Threats tests whether academics perceived types of threats differently,

Table 8.40
Academics: Variable Differences of Threats

Part A Variable	N	Mean Rank
Self-interest	49	100.77
Self-review	45	84.31
Advocacy	51	125.20
Familiarity	51	82.15
Part B	Test Statistics[a,b]	
Chi-Square		18.440
df		3
Asymp. Sig.		0

a. Kruskal Wallis Test
b. Group Variable: Threats

Academics' means rank for advocacy threat in table 8.40 part A, is the highest while the mean rank for familiarity threat is the lowest. This result is in agreement with all other stakeholder groups regarding advocacy threat; however, in disagreement regarding the effect of factors creating familiarity threat to auditor independence. Part B of the table shows that academics perceived types of threats significantly different ($p = .000 < .05$). When testing differences between two groups at a time, Table 8.41 Academics: Significance of Differences Between Threats (Mann-Whitney Test) shows that advocacy threat is perceived significantly different from all other types of threats.

Table 8.41
Academics: Significance of Differences Between Threats (Mann-Whitney Test)

Academics	Self-review	Advocacy	Familiarity
Self-interest	.185	.017*	.052
Self-review	--	.002*	.803
Advocacy		--	.000*

* Significant difference at $\alpha = 0.05$

Table 8.41 results show that academics view self-interest, self-review and familiarity threats similarly, whilst advocacy threat is perceived differently, indicating that for academics advocacy threat factors do not affect auditor independence.

Summary Six stakeholder categories contributed their views regarding factors causing four types of threat; also, whether auditor independence can be affected by such factors. The two auditor groups have almost the same view regarding self-interest threat. The finding for this research is that the major firm auditors considered factors causing self-interest threat as the greatest risk to auditor independence, followed by factors causing familiarity threat, whilst for minor firm auditors, self-interest threat was of interest, followed by self-review threat.

The users of financial statements, loan officer and financial analyst categories, have exactly the same view regarding factors affecting auditor independence. Both groups considered self-interest followed by familiarity threat as the greater risks. Thus, users of financial statements find that financial dependence on audit clients and a close relationship with the audit client can reduce the independence of the external auditor.

Financial directors, as responsible for preparation of financial statements, share the same view as minor firm auditors: auditor independence risks are self-interest threat followed by self-review threat. However, factors causing familiarity threat were not perceived as affecting auditor independence.

The academic category has a different opinion regarding the type of threat that affects auditor independence. This group perceived factors causing familiarity threat as risk to auditor independence, that a close relationship with an audit client may affect the auditor's decision thus impairing independence. This view was shared by the users of the financial statements.

All stakeholder categories perceived factors causing advocacy threat as factors that do not affect auditor independence. This indicates that assisting an audit client in making decisions regarding their financial statements and providing tax and zakat services for audit clients do not affect auditor independence.

Table 8.42 Category Participants' Rankings of Types of Threats shows how each stakeholder group ranked the risks to auditor impartiality.

Table 8.42 illustrates that major firm auditors, loan officers and financial analysts rank self-interest as the greatest risk to auditor independence, followed by familiarity, then self-review and last, advocacy. For minor firm auditors and financial director groups, the greater risk to auditor impartiality is self-interest, followed by self-review then familiarity and advocacy. The academic group differed so that familiarity was considered the greater risk, then self-review, self-interest and the last was advocacy threat.

Table 8.42
Category Participants' Rankings of Types of Threats

Variable	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Self-interest	1	1	1	1	1	3
Self-review	3	2	3	3	2	2
Advocacy	4	4	4	4	4	4
Familiarity	2	3	2	2	3	1

The finding of this research is that there is an agreement that factors causing a self-interest threat to auditor independence present the greater risk, while factors causing advocacy threat are the least risk.

Further, whilst table 8.42 presents stakeholders' perceptions on all types of threats in terms of ranking, it also illustrates a comparison of categories' ranking. For instance, the minor firm auditor group ranked self-interest first based on their mutual interests, while the academic group ranked it third. The comparison emphasises the various world views of the participant groups on auditor independence.

8.3.2 Differences between Groups

This section discusses the six stakeholder categories' attitudes to each threat and regarding each type of threat, whether their perceptions are statistically different. Each type of threat is thus examined to understand the factors by which groups perceive threats to auditor independence.

Self-interest Threat This type of threat occurs when auditors act in their personal self-interest. Participants were asked their opinion regarding a number of statements (Appendix I, Part 2) used to measure self-interest threat to auditor independence, with a focus was on financial interest with audit clients, presented as Table 8.43 Category Perceptions of Self-interest Threat.

Table 8.43 shows that the majority of major firm auditors, loan officers, financial analysts, and financial directors considered auditor independence to be affected by the financial dependence factors that create a self-interest risk, while the majority of the other two groups (minor firm auditors and academics) were neutral, indicating no effect on auditor independence.

Table 8.43
Category Perceptions of Self-interest Threat

Category Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	52.60	30.20	51.30	50.00	49.20	38.80
Neutral	42.10	62.30	46.20	45.20	44.40	55.10
Agree	5.30	7.50	2.50	4.80	6.40	6.10
Total (N)	38	53	39	42	63	49

However, more than 30 per cent of these two groups opined that auditor independence was at risk from self-interest threat. This indicates that the type of contractual relationship between the auditor and the audit client is an important factor in auditor independence. Table 8.44 Self-interest Threat: Differences of Categories continues the analysis.

Table 8.44
Self-interest Threat: Differences of Categories

Part A Category	N	Mean Rank
Major Firm Auditors	38	124.45
Minor Firm Auditors	53	172.79
Loan Officers	39	128.12
Financial Analysts	42	139.87
Financial Directors	63	134.52
Academics	49	147.70

Part B	Test Statistics[a,b]
Chi-Square	11.197
df	5
Asymp. Sig.	.048

a. Kruskal Wallis Test

b. Group Variable: q3

Table 8.44 part A shows the mean rank for the self-interest threat for each stakeholder category. The major firm auditors have the lowest mean rank while the minor firm auditors display the highest mean. With the exception of academics, the minor firm auditors mean is significantly higher than other categories, thus they have a differing opinion on self-interest threat, consistent with the results at s8.3.1. Part B of table 8.44 shows that stakeholder groups' perceptions were slightly different ($p = .048 < .05$), which reflects the result obtained in table 8.42 where five stakeholder groups ranked the self-interest threat first. Further analysis is shown at Table 8.45, Self-interest Threat: Significance of Differences Between Categories (Mann-Whitney Test).

Table 8.45
Self-interest Threat: Significance of Differences Between Categories (Mann-Whitney Test)

Self-interest Threat	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.012*	.733	.321	.463	.239
Minor Firm Auditors		--	.007*	.040*	.017*	.088
Loan Officers			--	.498	.733	.248
Financial Analysts				--	.711	.603
Financial Directors					--	.315
Academics						--

* Significant difference at α = 0.05

To locate the differences between stakeholder groups, the Mann-Whitney Test was conducted and the result is shown in table 8.45. The results for the minor firm auditors are significantly different from those of all other groups except the academic group. Thus major firm auditors, loan officers, financial analysts, financial directors and academics have a homogenous opinion regarding the effect of factors causing self-interest threat on auditor independence.

Self-review Threat This type of threat occurs when auditors audit their own work or the work of a colleague. The views of stakeholder categories regarding factors causing self-review threat to auditor independence are shown in Table 8.46 Category Perceptions of Self-review Threat.

Table 8.46
Category Perceptions of Self-review Threat

Category Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	45.00	27.80	33.30	42.50	59.70	55.50
Neutral	30.00	40.70	35.90	40.00	25.80	31.20
Agree	25.00	31.50	30.80	17.50	14.50	13.30
Total (N)	40	54	39	40	62	45

Categories of major firm auditors, financial analysts, financial directors and academics considered factors causing self-review threat as affecting auditor independence. However, the majority of the remaining two groups (minor firm auditors and loan officers) were neutral regarding the effect on auditor independence. Comparing this result with that for self-interest, where minor firm auditors were neutral, independence is thus not determined to be affected by factors causing self-review threat. Loan officers have a different perception of the self-review threat from their results from a self-interest threat. Academics, on the other hand, determined that the self-review threat affected auditor independence.

Table 8.47 Self-review Threat: Differences of Categories shows the result of testing whether stakeholder groups have significantly different perceptions regarding self-review threat.

Table 8.47
Self-review Threat: Differences of Categories

Part A Category	N	Mean Rank
Major Firm Auditors	40	149.61
Minor Firm Auditors	54	166.19
Loan Officers	39	163.09
Financial Analysts	40	135.30
Financial Directors	62	123.48
Academics	45	110.07
Part B	**Test Statistics[a,b]**	
Chi-Square	18.254	
df	5	
Asymp. Sig.	.003	

a. Kruskal Wallis Test

b. Group Variable: q3

Part A of table 8.47 shows that the academics have the lowest mean rank, while the minor firm auditor group has the highest mean rank. This indicates that the academic group is concerned about this issue and the minor firm auditors are the least concerned category regarding factors causing self-review threat on auditor independence. Part B of table 8.47 shows that stakeholder' categories have significantly different opinions on the issue ($p=.003 <.05$).

Table 8.48 Self-review Threat: Significance of Differences Between Categories (Mann-Whitney Test) shows the comparison test between categories based on their views regarding self-review threat.

The result from the academic group is significantly different from the two auditors and the loan officers. The perceptions of the minor firm auditors are significantly different from the financial analysts, financial directors and academics. These results indicate that the academic and the financial director groups represent the extreme negative view regarding the effect of self-review factors on auditor independence, while the minor firm auditor and the loan officer groups represent the opposite, positive view.

Table 8.48
Self-review Threat: Significance of Differences Between Categories (Mann-Whitney Test)

Self-review Threat	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.335	.505	.488	.090	.035*
Minor Firm Auditors		--	.830	.047*	.005*	.001*
Loan Officers			--	.101	.016*	.003*
Financial Analysts				--	.369	.158
Financial Directors					--	.256
Academics						--

* Significant difference at α = 0.05

Advocacy Threat This threat occurs when auditors act as advocates for or against their audit clients' positions, which may affect their independence. Table 8.49 Category Perceptions of Advocacy Threat explains this.

Table 8.49
Category Perceptions of Advocacy Threat

Category Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	7.50	1.90	2.60	16.60	8.10	21.60
Neutral	32.50	17.30	59.00	52.40	30.60	49.00
Agree	60.00	80.80	38.40	31.00	61.30	29.40
Total (N)	40	52	39	42	62	51

Table 8.49 shows that the majority of all stakeholder groups did not perceive factors causing advocacy threat to affect auditor independence. The academics had the highest percentage (21.6%) in terms of disagreeing with such factors followed by the financial analyst category (16.60%). Further, the majority of all participant categories did not perceive factors causing advocacy threat to impair auditor independence; however, the stakeholder groups have different perceptions. Table 8.50 Advocacy Threat: Differences of Categories presents these results.

The mean rank in part A table 8.50 shows that the academics have the lowest mean rank, followed by the financial analysts, while the minor firm auditors have the highest mean. This indicates that academics are most concerned regarding advocacy threat, whilst the minor firm auditors do not consider advocacy risk an issue. Part B shows that stakeholder groups are significantly different in their perceptions regarding the effect of factors causing advocacy threat to auditor independence (p = .000 <.05).

Table 8.50
Advocacy Threat: Differences of Categories

Part A Category	N	Mean Rank
Major Firm Auditors	40	173.00
Minor Firm Auditors	52	195.46
Loan Officers	39	135.46
Financial Analysts	42	98.35
Financial Directors	62	155.82
Academics	51	95.74
Part B	**Test Statistics[a,b]**	
Chi-Square	57.014	
df	5	
Asymp. Sig.	0	

a. Kruskal Wallis Test

b. Group Variable: q3

Table 8.51 Advocacy Threat: Significance of Differences Between Categories (Mann-Whitney Test) shows that the two auditor groups do not differ in their perception regarding advocacy threat.

Table 8.51
Advocacy Threat: Significance of Differences Between Categories (Mann-Whitney Test)

Advocacy Threat	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.295	.044*	.000*	.215	.000*
Minor Firm Auditors		--	.000*	.000*	.008*	.000*
Loan Officers			--	.017*	.170	.005*
Financial Analysts				--	.000*	.604
Financial Directors					--	.000*
Academics						--

* Significant difference at $\alpha = 0.05$

The academic and the financial analyst categories share the same opinions on advocacy threat; however, they are significantly different from the opinions of all other groups. These results indicate that, although all stakeholder groups perceived no effect of advocacy factors on auditor independence, significant differences exists for the purposes of this research. This result differs from the literature (e.g., Bartlett, 1993) regarding factors causing advocacy threat. Bartlett (1993) found that CPAs and bankers ranked assisting audit client in complex transaction third among ten cases indicating less independence.

Familiarity Threat This threat is caused by the influence of a close relationship between an auditor and audit client, which may increase the trust between these two parties. Table 8.52 Category Perceptions of Familiarity Threat analyses the results of these tests.

Table 8.52
Category Perceptions of Familiarity Threat

Category Response	Major Firm Auditor Percentage	Minor Firm Auditor Percentage	Loan Officers Percentage	Financial Analysts Percentage	Financial Directors Percentage	Academics Percentage
Disagree	39.00	12.50	46.20	46.50	22.20	64.70
Neutral	48.80	58.90	46.20	44.20	61.90	27.50
Agree	12.20	28.60	7.60	9.30	15.90	7.80
Total (N)	41	56	39	43	63	51

Table 8.52 shows that the majority of the academic and the financial analyst categories viewed factors causing familiarity threat to impair auditor independence. However, the majority of the minor firm auditors, major firm auditors and financial directors perceived less influence on auditor independence. The majority of the loan officer group was split between perceiving high impact on auditor independence and being neutral (undecided); however, a low 7.6 per cent perceived little impact on auditor independence. This indicates that the users of the financial statements recognise the impact of a close relationship between auditors and their clients on the auditor's independence. To test for significant difference between categories, Table 8.53 Familiarity Threat: Differences of Categories presents the results of this analysis.

Table 8.53
Familiarity Threat: Differences of Categories

Part A	N	Mean Rank
Major Firm Auditors	41	146.95
Minor Firm Auditors	56	196.75
Loan Officers	39	128.29
Financial Analysts	43	125.77
Financial Directors	63	165.78
Academics	51	101.42
Part B	**Test Statistics[a,b]**	
Chi-Square	41.816	
df	5	
Asymp. Sig.	0	

a. Kruskal Wallis Test

b. Group Variable: q3

The mean rank for each stakeholder group is shown in part A of table 8.53, which shows that minor firm auditors have the higher mean rank while the academic category has the lower. This indicates that the academic group are more concerned about the close relationship between the auditor and the audit client, while the minor firm auditors show less concern regarding the issue. Part B shows that stakeholder groups are significantly different in their perceptions regarding the effect of factors causing familiarity threat on auditor independence.

Table 8.54 Familiarity Threat: Significance of Differences Between Categories (Mann-Whitney Test) shows significant differences between categories.

Table 8.54
Familiarity Threat: Significance of Differences Between Categories (Mann-Whitney Test)

Advocacy Threat	Major Firm Auditors	Minor Firm Auditors	Loan Officers	Financial Analysts	Financial Directors	Academics
Major Firm Auditors	--	.003*	.341	.180	.222	.007*
Minor Firm Auditors		--	.000*	.000*	.038*	.000*
Loan Officers			--	.838	.021*	.099
Financial Analysts				--	.017*	.096
Financial Directors					--	.000*
Academics						--

* Significant difference at $\alpha = 0.05$

Table 8.54 shows that major firm auditors have a significantly different perception than minor firm auditors and academics on this risk. The minor firm auditors are quite positive regarding the effect of familiarity on auditor independence and they have significantly different opinions. The financial directors share the same views as the major firm auditors; however, their perceptions significantly differ from all other stakeholder categories. For the users (loan officers and financial analysts), no significant difference was found, indicating similar opinions regarding the effect of familiarity factors on auditor independence.

Summary In this section, the six stakeholder groups were tested regarding their perceptions for each type of threat. Table 8.55 Category Participants' Rankings of Types of Threat*s* shows how stakeholder categories rank types of threats in terms of threatening auditor independence.

The major firm auditors were the most concerned group regarding the effect of self-interest factors on auditor independence, while the minor firm auditor group was the least concerned category about all types of threats. This indicates that both auditor groups have different perceptions regarding the type of threat that affects auditor independence. Further interest about self-interest factors was noted by the loan officers, followed by the financial directors' category.

Table 8.55
Category Participants' Rankings of Types of Threats

Threats Category	Self-interest	Self-review	Advocacy	Familiarity
Major Firm Auditors	1	4	5	4
Minor Firm Auditors	6	6	6	6
Loan Officers	2	5	3	3
Financial Analysts	4	3	2	2
Financial Directors	3	2	4	5
Academics	5	1	1	1

The findings from this research are that the academics were concerned regarding all types of threats except the self-interest threat, where the group comes in the fifth place. It can be concluded that, in general, the academic category is the most conservative group regarding the effect of the NAS on auditor independence, whilst the minor firm auditor group is far less conservative about the implications of auditor independence.

8.4 Chapter Summary

This chapter presents the inferential or the confirmatory data analyses using non-parametric testes such as the Kruskal-Wallis Test and the Mann-Whitney Test and the results obtained to investigate the research questions of this study. Eight hypotheses regarding issues related to the effect of the joint provision of audit and NAS were tested. The first hypothesis relates to the importance of auditor independence as a general principle. The next three hypotheses cover issues relating to participant categories' opinions on the effect NAS on auditor independence, including whether auditors can maintain their independence while providing NAS for their audit clients and whether auditor independence will be affected by NAS, and finally, the separate effect of these NAS issues on audit quality.

Four other hypotheses were tested related to factors enhancing auditor independence. These factors include banning auditors from providing NAS for their audit clients, separation of NAS and audit personnel, supplementary disclosure of audit and NAS fees and relevant NAS information that auditors provide, and restricting recruiting arrangements with audit clients. The next section discussed the four types of threats and the manner by which stakeholder categories perceive these threats and significant differences that occur.

The next chapter will present the conclusion of the study and recommendations for further research.

Chapter 9 Summary and Conclusions

9.1 Introduction

This thesis contributes to the growing literature on the provision of audit and non-audit services (NAS) for an audit client, and the effect of joint provision on auditor independence in an environment where such provision is banned. The empirical and quantitative research assesses extant literature and selects contributory factors from prior studies that are relevant to the audit environment in Saudi Arabia. These factors are grouped into those that could adversely influence auditor independence, those with the capacity to enhance auditor independence, and types of threats affecting auditor independence. A study of opinion of the Saudi population of stakeholders in auditor impartiality was undertaken to determine priorities the various stakeholder categories placed on these factors.

This study was influenced by a considerable body of literature that focuses on the meaning of independence, and factors that may impair it in various auditor-client relationships, including the provision of NAS for audit clients. Extant literature is general in its approach, with the majority of the research relating to developed economies where NAS is allowed and little relating to the phenomena in emerging economies where NAS is banned, including that of Saudi Arabia. Further, most empirical studies investigate the provision of NAS in its entirety, without attempting to elicit information regarding the components of NAS. To investigate the effects of NAS on auditor independence, the type of factor and the class of threat involved in the service should be identified. This concept is the threat-safeguard approach, developed by the US Independence Standard Board (ISB) as an alternative to the regulatory approach of the US Securities and Exchange Commission. The threat-safeguard model was then adopted by the International Federation of Accountants and other accounting organisations such as the Institute of Chartered Accounting in England and Wales, and the Institute of Chartered Accountants in Australia. The threat-safeguard approach is the auditor independence model that is the subject of this study, and the thesis was developed accordingly. This chapter is organised as follows.

A brief review of each chapter is provided in the next section. The major findings of this study are presented in the third section. The fourth section of this chapter covers some recommendations for regulators and decision-makers. The fifth section discusses limitations of this study and the final section shows some opportunities for future research.

9.2 Review of Thesis

The nature of the research was introduced in chapter 1, which covers the principles and issues for investigation, research objectives, and the methodology employed. To inform the reader on the country where this study was conducted; information about Saudi Arabia was presented in chapter 2 Context of the Research. This information included a brief reference to the Saudi environment, demographics and history, government and legislature, and economic development. Particular to this study, further explanation was provided on Saudi financial structures, its accounting and auditing regulations and standards, and finally its response to auditor independence.

A review of the relevant literature was presented in the following two chapters. Chapter 3 Review of Auditor Independence provided a comprehensive review of the regulatory frameworks of auditor independence. This includes definitions of auditor independence; different interpretations of auditor independence (e.g., Antle, 1984; DeAngelo, 1981b); a review of auditor independence rules and regulations in developed economies including US, UK and Australia; and finally the relationship between auditor independence and the provision of NAS (e.g., Arruñada, 1999b; Colson, 2004).

The empirical literature was presented in chapter 4 Review of NAS Effect on Auditor Independence, which covers empirical studies on this matter. Assessment of the literature findings concluded that the possible outcomes to NAS impact on auditor independence were a negative effect, a positive effect or no effect (e.g., Shockley, 1981; Beattie and Fearnley, 1998; Jenkins & Krawczyk, 2002). Authors of the empirical studies applied a number of methods and models such as survey and archival methods to investigate both the appearance and factual nature of independence. Limitations were identified, such as authors who placed greater emphasis on investigating factors that cause self-interest threat (e.g., Lennox, 1999; Craswell, 1999; Jenkins and Krawczyk, 2002); whereas few researchers investigated other types of threats such as self-review, advocacy, and familiarity threats (e.g., Hussey, 1999; Geiger, Lowe and Pany, 2002). It was also argued that the internal validity of some of the questionnaires used to collect data from the participants is questionable, which may raise the risk of demand effects (e.g., Pany and Reckers, 1987). Another limitation is that the results of these studies are difficult to disseminate across countries and over time due to the differences among countries in terms of their economic and regulatory environments. This leads to the fourth limitation, that several recent studies have reported positive impact of the joint provision of NAS and audit services on auditor independence (e.g., (Lowe et al, 1999; Canning & Gwilliam, 1999; Jenkins & Krawczyk, 2002), which may indicate recognition of potential advantages in NAS.

Chapter 5 Research Conceptual Framework discussed the structure for this research. The auditor independence framework, developed by the ISB, was introduced and discussed in detail. Four types of threat emanating from the provision of NAS were identified: self-interest, self-review, advocacy, and familiarity. These threats, which may or may not compromise auditor independence, occur through various auditor-client relationships, activities or other circumstances relating to the provision of NAS. By identifying and analysing threats to auditor independence, risks are mitigated or eliminated and auditor impartiality is enhanced. The research questions related to the participants' views on NAS and auditor independence were introduced and discussed (Appendix I).

Chapter 6 Research Method introduced the methodology employed in this study, a quantitative research methodology. The data were selected using a questionnaire instrument that was discussed in detail. The study participants were selected from four major categories: auditors, users, preparers, and academics. Further, the auditor group was divided into major and minor firm auditors, and the user group was also divided into loan officers and financial analysts. This strategy sought to encompass the population of stakeholders in auditor independence in Saudi Arabia, rather than a sample that may prove to be unrepresentative of those depending on the impartiality provided by audited financial statements.

Chapter 7 Data Analysis: Descriptive Statistics and chapter 8 Data Analysis: Inferential Statistics presented these analyses. In the descriptive analysis chapter, the demographic information on the participants was presented and discussed. In addition, relationship issues and activities related to the provision of NAS were then investigated by means of obtaining the frequency distribution of the variables. Chapter 8 presented the inferential analyses that focused on testing a number of hypotheses and investigating differences among categories regarding types of threats affecting auditor independence. The implications of such results obtained in both chapters (7 & 8) are discussed in the next section. Finally, this chapter is described in the introduction.

9.3 Major Findings

This study investigates the views, opinions and perceptions of stakeholders on effects of NAS elements on auditor independence. Chapter 8 presented the results of eight hypotheses, where the first four relate to the effect of NAS on auditor independence, while the remaining four hypotheses relate to factors that may enhance auditor independence.

9.3.1 NAS and Auditor Independence

The independence of the auditor is a fundamental issue to the reliability of auditors' reports and critical to acceptance of financial statements as the basis of decisions of a commercial nature. Six stakeholder categories were identified: major firm auditors, minor firm auditors, loan officers, financial analysts, financial directors, and academics, representing four major categories: auditors; users; preparers; and academics.

First Hypothesis This hypothesis tested stakeholder categories' views on the significance of auditor independence. The majority of participants and categories recognised the importance of auditor independence and there was no significant difference between the categories. This uniform response was determined as a result of the participants' standing in the research as sophisticated users of audited financial documentation. This result is consistent with previous studies' findings that the more familiar participants are about auditing the more likely they are to recognise the importance of auditors to be independent (Beattie et al., 1999). As an indicator of the participants' understanding of financial implications of auditors' independence, analysis in chapter 7 shows that most stakeholders hold at least a bachelor's degree, with at least 7 accounting subjects taken during their studies. Of the loan officer and financial analyst categories, for example, over one-third (38%) hold a master's degree.

Second Hypothesis The hypothesis of allowing auditors to provide NAS to audit clients was tested. Participant categories were not significantly different in their responses, with the exception of the minor firm auditors and the two user groups (loan officers and financial analysts). Minor firm auditors, financial directors, and academics, as knowledge-rich participants, approved auditors to provide NAS for their audit clients. This tendency to be flexible about NAS provision confirms research findings (e.g., Mednick, 1990; Bartlett, 1993). The minor firm auditors' perception is also consistent with the result reported by Hudaib (2003) where the majority of the same category supported NAS to the audit client.

The finding is attributed to the extra depth of knowledge of the client's business that an auditor obtains through NAS, and the client's affirmative response.

Third Hypothesis_Maintaining independence while providing NAS for audit clients is the subject of this hypothesis. Participant groups were significantly different in their views regarding auditors' independence when providing NAS. Both auditor categories reported that auditors could remain independent, considered independence-in-fact. In the non-NAS Saudi[22] accounting environment, however, major firm auditors did not approve auditors to provide NAS while the minor firm auditors approved the concept. The latter response relates to the fact that minor firm auditors rely on income generated from NAS more so than from their audit services. It may also indicate that major firm auditors are more concerned about independence-in-appearance, the façade of auditor independence presented to users of the financial statements under circumstances where auditors do not provide NAS. The auditor participators' positive views on the maintenance of auditor propriety are consistent to a degree with the self-serving bias concept where both groups were found to be less likely to believe that auditors cannot maintain their independence when providing NAS for the audit clients.

Users of the financial statements, financial analysts and loan officers, are of the opinion that auditors cannot maintain their independence when providing NAS; however, Jenkins and Krawczyk (2002) reported that the provision of NAS positively influenced users' perceptions of independence. Thornton et al (2003) also reported that a majority of loan officers agreed to NAS provision by an external auditor. These results were not obtained in this study and thus the opinions of users of financial statements cannot be determined.

Academics agreed to allow auditors to provide NAS and that independence can be maintained under these circumstances; however, the majorities were not substantial leading to an assumption of a divergence of opinion among academic participants. To enhance auditor independence in this environment, safeguards for NAS are important.

Fourth Hypothesis_Another view holds that audit quality is improved when NAS is provided for audit clients. The majority of all respondents agreed that NAS provide auditors with a greater understanding of their client's business, encourages audit quality, and assists auditors' recommendations on clients' operational effectiveness. Nearly three-quarters (70%) of the auditor categories and the financial directors agreed that NAS improve audit quality;

[22] Tax and zakat services are permitted.

however, a bare majority (55%) of the user groups (loan officers and financial analysts) and the academics supported this view. These findings are consistent with the results obtained by Thornton et al. (2002) who found that public accountants differed significantly from the major accountants (preparers) and bankers (users). The responses of the user categories and academics reflect an assumption of auditor competence, with or without NAS.

The next four hypotheses relate to factors that may enhance auditor independence. Safeguards can be set in place to mitigate or eliminate threats to auditor independence.

The joint provision of audit and NAS for audit clients is not permitted in Saudi Arabia; similarly it is banned in Belgium, France, and Italy (Lennox, 1999). The argument against auditor provision of NAS is to ensure auditors focus only on an independent attestation service (auditing the financial statements) to maintain audit quality. Researchers recommending NAS focus on its economies of scope that should lead auditors to understand their clients' businesses (Arruñada, 1999a).

Fifth Hypothesis This hypothesis tested whether prohibiting NAS for auditors ensures audit quality. The participants differed significantly; minor firm auditors, loan officers, and financial directors disagreed with this prohibition, the majority of major firm auditors, financial analysts, and academics were supportive. The minor firm auditors were significantly different from all other groups. The minor firm auditor and financial director categories supported NAS and agreed that auditors can maintain their independence in that instance. This consistency differed from other categories in their views that there are benefits from NAS for audit clients, in fact, both auditor categories and financial directors presented majorities approaching 70 per cent in support of NAS.

Paradoxically, the academic participants who approved the Saudi prohibition of NAS also supported the provision of NAS and that auditors are able to maintain their independence under the circumstances. The inconsistency of the academic category's responses may be traced to a purist, independent position whereby they respond to each point in isolation. Thus, the argument stands that, whilst the other participant categories work in their professional environments and to a minor extent share common and coherent views, the academics present an individualistic mindset based on the issue at hand. The academics' reversal may also relate to a semantic difference in the wording of the statements. The first statement 1.2 (table 7.13) related to 'auditors' whilst a further statement 6.1 (table 7.16) related to 'audit firms'. These terms may have been interpreted differently by the academic participants, some of whom were also expatriates. The concept of a Saudi individual as an auditor arguably raised a positive response, inasmuch as there are few Saudi accountants and auditors to meet the regulatory load. Further, the differing regulatory requirements, Shar'ia and secular, enhance this view, as the majority of accountants are Islamic, and they acknowledge the compelx nature of their financial world. On the other hand, the notion of 'audit firms' reflects international conglomerates and the inability of international regulations over the past decade to control the activites of these firms are uppermost on the minds of the academic participants.

Sixth Hypothesis The major finding regarding separation of NAS staff in an audit client's premises from the external audit staff is that the minor firm auditors differed significantly from all other stakeholder categories. In terms of percentages, minor firm auditors, academics, and financial directors agreed with NAS if there is separation of staff within the audit firm. The remaining participants differed in their views, but the results showed no significance.

There were inconsistencies in views on NAS upon separation of audit staff. For instance, the loan officers disagreed with the prohibition of NAS; however, the category had a neutral result to separation of staff. Financial analysts, as users of audited documentation, agreed with NAS prohibition, despite the proviso of separation of staff. Moreover, minor firm auditors approved of NAS for audit clients; and for separation of NAS and audit staff as a safeguard.

Seventh Hypothesis Disclosing additional information on NAS and audit activities is useful as a safeguard for auditor independence; audit and NAS fees, types of NAS provided by the external auditor, and the pre-approval requirement of NAS by the client's audit committee. As Saudi Arabia prohibits non-tax and zakat NAS by auditors, these provisions were included in this research for completeness only, and to survey participants' opinions on possible future safeguards, should legislation change.

The stakeholder categories differed significantly in their views regarding improved auditor independence through company disclosure of supplementary data such as quanta of audit and NAS fees, and details of NAS. The majority of participants and categories agreed that supplementary disclosure of such information enhances auditor independence. The two user groups and the academics strongly supported this action, while the two auditor groups and the financial directors were weakly supportive. Auditors and users of the financial statements differ in terms of the effect of such disclosure on auditor independence. Previous studies (e.g., Lennox, 1999) indicate that when companies disclose NAS fees, the financial market reacts positively. Audit and NAS fee disclosure differentiates reputable auditors. Ackert, Church and Schneider (2007) found that when NAS fees exceed audit fees, the financial investment in companies audited by less reputable auditors is reduced relative to that in other companies audited by reputable auditors. In Saudi Arabia, Hudaib (2003) states that bank-based credit managers (loan officers) classify auditors so that a large company audited by a minor firm will not be considered for a loan by credit mangers. Lender institutions adopt this practice to assure the quality of the financial information provided by borrowers.

Eighth Hypothesis With the exception of the minor firm auditors, all categories agreed that external auditors should not provide executive recruiting services for their audit clients, further, audit clients should not offer jobs to their external auditors or their personnel. The categories displayed significant differences, and the financial analysts and the academics were significantly different from all other groups inasmuch as they strongly supported the prohibition.

Companies frequently hire former external auditors' employees. Beasley, Carcello, Hermanson, and Lapides (2000) state that companies hire former employees of their external auditors as those employees are highly trained and experienced regarding different types of businesses. Less commonly, audit firms may hire former audit clients' employees. It is argued that when a company hires a former external auditor's personnel, the independence of that external auditor is jeopardised. The US *Sarbanes-Oxley Act (2002)* restricts companies hiring a former external auditor's employee; however, it does not restrict auditors hiring a former audit client's employee.

The results of this study are consistent with the argument that employment by a client of an executive of the audit firm may weaken the independence of the auditor; however, previous research has mixed results. Some authors (e.g., Iyer & Rama, 2004) find that prior audit experience of a company executive with the external auditor was not related to client's perceptions about their ability to persuade the auditor to accept their position in case of a disagreement, that is, audit independence is not affected by the employment factor. However, other authors (e.g., Lennox, 1999) find that companies receive clean audit opinion significantly more when executives were working with the audit firm before moving to work with the client; that is, independence-in-fact may be questioned. However, in this study, loan officers, financial analysts, financial directors, and the academics support prohibition of employment with audit clients due to the potential negative impact on auditor independence.

Independence-in-fact may not be affected by the prior employment with the external auditor; however, the independence-in-appearance may be affected. The weak support that comes from the auditor categories may be referred to the fact that auditors normally work with audit firms to improve their skills to further their careers.

9.3.2 Threats to Auditor Independence

When auditors provide NAS for their audit clients, certain types of threat may occur. These threats are: self-interest; self-review; advocacy; and familiarity. In this study, stakeholders were asked their views regarding issues related to each threat. Accordingly, the investigation of stakeholders' perceptions took two paths; each participant category's perception of the threats and significant differences that occurred; and second, stakeholders' opinion of each type of threat and whether significant differences exist.

Differences Among Types of Threats Each stakeholder category was examined regarding their opinions on types of threat and whether significant differences exist. Each group differs significantly when considering the types of threat to auditor independence. The major finding is that the self-interest threat to auditor independence was selected by five categories: major firm auditors, minor firm auditors, loan officers, financial analysts, and financial directors. The academics differed in their selection of familiarity as the greatest risk to auditor independence.

The familiarity threat was rated next for the major firm auditors, loan officers and financial analysts, while the self-review threat was selected by minor firm auditors, financial directors, and academics. All stakeholder categories selected advocacy threat as of the least risk to auditor independence, thus all participant majorities agreed that assisting audit clients and providing tax and zakat services for the audit client would not impact auditor independence. The last result justifies the regulators' action to allow auditors to provide tax services for their audit clients.

Whilst the major firm auditor group selected self-interest and familiarity threat as the greater risks, the majority of the minor firm auditors were neutral regarding self-interest, self-review, and familiarity; however, nearly one third (30%) selected self-interest as a risk, conforming in part to the other categories.

The two user categories, loan officers and financial analysts, agree in their perceptions regarding all threats affecting auditor independence. They selected self-interest as the greater risk, followed by familiarity, self-review and finally advocacy as the least risk. The two user groups noted factors such as the depth of the auditor-client relationship as representative of familiarity threat to auditor independence. This result is consistent with Hussey (1999) who found that increasing the relationship between auditors and their audit clients is a danger to auditor independence.

The financial directors and the minor firm auditors (the latter as a minority) selected self-interest and self-review threats, in that order. Thus, an auditor who becomes financially dependent on an audit client may risk impartiality. Moreover, these categories recognised the risk when auditors provide NAS so that they evaluate their own work. The academics differed with the other categories, selecting familiarity and self-review as risks to auditor independence.

As noted, self-interest was generally selected as the greater risk, then self-review and familiarity threats. Last, the participants dismissed advocacy threat.

Differences Among Stakeholder Groups This section examined how participant categories perceived each threat. The results of each participant category and each threat were compared to determine significant differences, and if so determined, how they were ranked.

The research shows that stakeholder categories were significantly different in their responses regarding self-interest threat. A significant difference exists between the minor firm auditors and all other categories except the academic group, while the results of all other categories were not significantly different. This indicates that minor firm auditors differ in their results regarding a self-interest threat to auditor independence. The self-interest threat was considered neutral to auditor independence by the majority of the academic and the minor firm auditor categories. Around one third (39%) of academics and minor firm auditors (30%) considered self-interest as a threat. The result is consistent with the result obtained by Beattie et al. (1999) where stakeholder categories were found to be negatively affected by factors creating a self-interest threat such as the economic dependence of the auditor on the audit client, and the provision of NAS and overdue audit fees. This result for the academic group is consistent with the result shown previously in this section; the academics regarded self-interest as a secondary threat to auditor independence. Of all the participants, self-interest threat is considered of prime risk to impartiality by the major firm auditors, then the loan officers and the minor firm auditors are the group least concerned.

The self-review threat has little attention in the literature as few researchers investigated causes for this type of threat. Lavin (1976) found that just under half of users believe that the provision of accounting services would impair auditor independence; however, this percentage dropped to one third for more limited accounting services. In this study, stakeholder categories evidenced significantly different results regarding self-review threats to auditor independence. While the minor firm auditors did not consider self-review impeded auditor independence, the majorities of the remaining groups differed, with the academic group reporting the greatest concern on the matter followed by financial directors. The minor firm auditors were the least concerned. The results regarding the minor firm auditors and loan officers are consistent with the results obtain by Hudaib (2003) where the majority of minor firm auditors and credit managers (loan officers) in Saudi Arabia did not foresee any problem in the provision of bookkeeping services for audit client, as these services are technical and not related to decision-making process.

The stakeholder categories differed significantly regarding the advocacy threat; however, all stakeholder categories were least concerned about the effect of advocacy threat factors than other threats on auditor independence. This result may be influenced by the fact that the provision of tax and zakat services in Saudi Arabia is allowed while the provision of any other NAS is prohibited. Both auditor categories presented high means rank in the analysis, indicating that advocacy threat is low when auditors provide tax or zakat services to audit clients or assist them with decisions for complex transactions. This is perhaps due to a perception that assisting in the decision-making was perceived to be remote from the decision itself.

A familiarity threat arises when auditors put trust in their clients and then accept their viewpoints. Trusting audit clients may arise when an auditor has close or long-standing personal or professional relationship with an audit client (ISB, 2000). In this study, two types of factors were examined, the type of relationship between an auditor and an audit client, and the provision of recruitment service to an audit client, both of which may strengthen the trust between the auditor and the management team of the audit client. Stakeholder categories were significantly different, as expected, on the manner by which familiarity threat may impair auditor independence. While the majority of the academic and the financial analyst categories perceived auditor independence to be impaired by factors causing familiarity threat, both auditor categories and financial directors disagreed. The minor firm auditors and the financial directors were the least concerned categories, while the academics and the financial analysts were the most concerned. These results are expected in a situation where financial directors or the audit client's management participate in selecting the external auditor, and this relationship may also deepen when the managers for the audit client were recruited by the external auditor.

9.3.3 Saudi Arabia Context

For Saudi Arabia and the other GCC countries of Bahrain and Kuwait, auditor independence has wider issues than the threats to independence for all auditors identified through IFAC and others[23]. Whilst self-interest, familiarity, self-review and advocacy are global risks to the client and auditor relationship, and through that to users of financial statements, these threats, or risks, can take on different guises in emerging economies.

There are competing influences among the Saudi population, common to Arabic countries and the Gulf area in particular. Whilst international standards govern the trade and professional practices of the dominant foreign corporations, the hierarchical tribal system and strong class structure in Saudi society determines power and therefore influence on key government policies. The class structure acts as a powerful source of prestige and social status; however, it also limits social, economic and political activity. In a close society, the pressure of conformity leads to fatalism, wasta (nepotism) influence used for job-seeking, and the domination of key positions by an elite and tribal network may limit professionalism in many key institutions. Another factor in close societies is confidentiality, especially in regard to business activities, which impacts both the extent and quality of information disclosed to authorities. Further, Saudis tend to dismiss regulations and the frequent absence of enforcement exacerbates this tendency. (Haniff & Hudaib, n.d [University of Exeter]).

SOCPA is working towards adoption of IFAC standards to improve its international standing (no. 80 on Transparency International's 2008 CPI,[24]). When international standards are adopted by an emerging economy, assumptions of governance structures: professional and technical resources, systematic reporting, long term statistics and underlying accounting knowledge and skills are available to the majority of firms in the sector. In this thesis, the number of professional users of financial instruments were such that the Saudi user population were identified and approached as the study sample. As such, few individuals are in a position to act as auditors alone; the majority of participants acknowledged this fact and approved of auditors also performing NAS.

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[23] The remaining GCC countries, Oman, Qatar and UAE, are not members of IFAC.
[24] Corruption Perceptions Index, accessed 6 January 2009 from http://www.transparency.org/news_room/in_focus/2008/cpi2008/cpi_2008_table

The self-interest risk is arguably higher in the close society of Saudi Arabia. Whilst family or tribal connections could result in undeclared equity or close relationships, other self-interest factors relating to income or promise of jobs (wasta) could also apply. The familiarity threat is also higher than in a developed economy, for similar reasons. A self-review threat is a real risk, due to the lack of qualified Saudi auditors, their associated tax and zakat work, and the turnover rate of expatriate accountants working within a single firm (generally 2-year tenure). Finally, there is a lower risk of advocacy, due to the low level of action by the various authorities and the difficulty in assigning jurisdiction between them.

9.4 Recommendations Enhancing Auditor Independence

Significant differences exist among cultures in understanding the concept of auditor independence (Patel & Psaros, 2000). This may explain why auditing should be considered a social practice and then developed within the context of a particular environment. The concept of auditor independence, perhaps the cornerstone of auditing, should also be understood and developed in the same context to the environment in which it is practised. In this study, the investigation revealed insights into the manner by which stakeholders perceive the effect of the joint provision of audit and NAS on auditor independence in Saudi Arabia. Accordingly, recommendations are provided based on consideration of the findings of this study.

Saudi Arabia prohibits auditor NAS, except tax and zakat services, due to the risk to auditor independence. Based on the findings of this study, the majority of stakeholder categories agreed that, in general, allowing auditors to provide NAS would improve audit quality. This result is consistent with prior studies (e.g., Palmrose, 1986) where their results were consistent with increased quality of audit services. Moreover, previous studies found that not all NAS involve risk to auditor independence. Hudaib (2003), in a Saudi study, found that the practice of NAS services, other than tax and zakat services, was still widespread in Saudi Arabia despite the prohibition. There are implications for this study stemming from the inability of the relevant authorities to implement auditing controls caused by the lack of qualified and experienced auditors and the country's reliance on expatriate assistance. It is necessary that further attention be given by SOCPA to continual training for existing practitioners and to encourage students to adopt auditing as a career. There are options to prohibition of existing NAS restrictions in the Kingdom: prohibit certain NAS, or allow a greater range of NAS but require full disclosure. Thus, the recommendation of this study is that NAS should be allowed for audit clients and safeguards undertaken to maintain the independence of the external auditor. Based on the findings of this study, the strategy is as follows.

Restrict NAS with Proven Risk to Auditor Independence The findings of this research are that stakeholder categories were aware of NAS in the form of technical accounting services to clients. Accounting services can create a self-review threat to auditor independence. However, apart from decision-making, other types of NAS were accepted in this study as they do not impair auditor independence. To extend upon these findings, auditors can benefit from NAS through an improved quality of audit. Thus, the conclusion of this research is that instead of prohibiting non-tax and zakat NAS, NAS prohibitions otherwise may actively work against auditor independence rather than promoting it.

Mandatory Disclosure of Fees The conclusion of this research is that a mandatory disclosure of audit and NAS fees is supported. This result is also supported by results of previous studies (e.g., Lennox, 1999; Francis & Wang, 2004). These studies found that non-disclosure of audit and NAS fees affect auditor independence; however, disclosing such fees enhances auditor independence that embraces public accountability. Moreover, it was found that public disclosure of audit and NAS fees not only strengthens auditor independence but also improves the precision of audit pricing. Other studies (e.g., Frankel, Johnson & Nelson, 2002) found that the share market reacts to the disclosure of audit fees, which means that the market can play the role of safeguarding auditor independence, confirmed by Arruñada (1999b). Thus, it is recommended that legislative policy should aim at disclosing valuable information such as audit and NAS fees.

Disclosure of NAS Not all types of NAS reduce auditor independence; however, only certain NAS can impair auditor independence. (Schleifer & Shockley, 1990). In this study, company disclosure of types of NAS and audit services improve auditor independence. Thus, determining the type of threat affecting auditor independence depends on knowing the type of NAS provided. For instance, the self-review threat may occur when an auditor provides accounting services or implements an accounting program for an audit client. Thus, it is recommended that disclosure by supplementary notification of types of NAS provided by the external auditor by a company enhances auditor independence.

Pre-approval of NAS Policy Audit committees of companies should be required to pre-approve all NAS performed by the incumbent auditor to assure auditor independence. Minor approvals relate to services that are deemed to have a lesser effect on auditor independence, such as tax and zakat services. Other forms of NAS may impair auditor independence, such as the provision of bookkeeping services for audit clients and the client's audit committee should consider these separately. Further, proposed NAS should have a pre-approved cost level from the audit committee to ensure that contracted audit firms are deemed not financially dependent on the audit client.

NAS implementation must be disclosed as supplementary information for users of financial documentation, together with an acknowledgement of responsibility and compliance from the audit committee. This should promote effective corporate governance of registered companies and will increase audit committees' accountability to investors and creditors.

<u>Separation of Audit and NAS Personnel</u> An alternative to the current level of Saudi prohibition on NAS for audit clients is a distinct separation of duties where the personnel performing NAS differ from the auditors. There is a concept of the *Chinese Wall* that describes this separation. All professionals are under a mandate that they will not communicate sensitive client information between the external auditors and the external NAS providers of a given audit firm. In other words, audit firms should totally and utterly divide their functions according to their services, audit and NAS. Both teams report to different executives, who maintain their responsibilities at board level for the audit firm, as practised by the global accounting services. Separation of personnel within a minor audit firm strengthens public confidence. In this study, it was found that auditor independence is stronger when there is a separation of personnel. Applying such practices requires audit firms and local audit offices to state clearly the identities of the audit team and the NAS team with the SOCPA.

<u>Relationships with Audit Clients</u> The depth of relationship with an audit client is of concern for auditor independence. Certain relationships with audit clients may create a familiarity threat to auditor independence (e.g., ISB, 2000; IFAC, 2006). These situations may cover different types of relationship such as the lengthy audit tenure, employment with audit clients and also employment with audit firms. In Saudi Arabia, the *Companies Act* (s 2.6.2), the *Statutory Accountants Act* (s2.8.3), and the *Professional Code of Ethical Conduct* (s2.8.4) control situations that may affect auditor independence; however, other situations require intervention to enhance auditor independence, especially employment with audit clients. Thus, it is recommended that a year cooling-off period is required before a member of the audit engagement team can begin working for the audit client in certain key positions. This

recommendation, similar to the employment restrictions of Australia, US, and Canada, should apply to all employee transfers between auditors and their clients.

Further, the length of audit tenure to a given client should not exceed 5 years. However, because of the small professional audit group in Saudi Arabia, and the prohibition to forms of NAS, difficulties in applying such procedures may arise. Another point is that very few large audit firms are eligible to audit companies listed in the capital market, which means that the companies do not have a choice in their auditors. Thus, the question here is: when should a company return to a previous external auditor? Moreover, when an auditor cannot provide NAS, the client must find another accounting firm for these services, or conduct them in-house. This means companies will have fewer choices when it comes to providing audit services. This issue rises repeatedly for financial institutions, such as banks, where a further injunction is that such institutions must be audited by two audit firms (Appendix IV).

9.5 Limitations

This study has several limitations that should be taken into consideration. First, this study investigates the perceptions of six stakeholder categories on the effect of the joint provision of audit and NAS on auditor independence. These six stakeholder categories are: major firm auditors, minor firm auditors, loan officers, financial analysts, financial directors, and academics. Other stakeholder categories, such as shareholders and the general public, being secondary users of financial documentation to the professional categories, are not covered in this study. Second, this study has reference to the auditing environment of Saudi Arabia, although there is a consensus with the literature for the research conclusions.

Participants in the financial director group are financial directors and account managers in public-held companies registered in the Saudi Stock Exchange. Other companies such as privately held or family held companies are not covered in this study. Concerning threats to auditor independence, findings are restricted to the use of certain measures, using different measures for these threats may produce different results. Data were collected using a survey questionnaire technique. This technique is subject to certain types of bias such as the response bias, which may affect the reliability of the respondents' answers. Certain procedures were taken to ensure biases were avoided. Finally, this study investigated practices used as safeguards to auditor independence when NAS are involved; however, there are some other practices from the literature that need to be investigated such as reputation value, peer-review programs, and corporate governance practises.

9.6 Future Opportunities

Unlike most of the developed countries where secondary data are available due to the advanced disclosure requirement, this study used a survey questionnaire technique to collect its data. Thus, with disclosure that leads to the availability of the secondary data, more studies on developing countries, such as Saudi Arabia and the countries of the Gulf Cooperation Council in general, are needed to provide a research base for independence policy decisions.

There is also a lack of research focused on investors' perceptions in developing countries. The investors' view of auditor independence is important to regulators.

Future studies should focus on the following:

- Stakeholders' perceptions on auditor independence of NAS components, such as the nine types of NAS prohibited by the US SEC.
- Research using archival data (secondary data), such as audit and NAS fees and other types of data when available. This will enable researchers to make a logical comparison of the results obtained with the results from studies conducted in other countries.

9.7 Final

This thesis is a confirmation of my belief that the social and economic future of Saudi Arabia is predicated on an efficient and well-considered financial environment. The enormous wealth flowing into the Kingdom can only be harnessed if Saudi Arabia acknowledges its responsibilities to record, utilise, and disseminate its riches for the community it serves. I again thank the stakeholders to this research and wish them every success in bringing our Kingdom to the forefront of the world's developed economies. I commend this work to its readers.

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Appendix I: Questionnaire Material

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VICTORIA UNIVERSITY OF TECHNOLOGY

Survey

Invitation letter for participants

Dear Mr./Ms.

I am conducting a survey of how auditors and users of financial information perceive the effect of the provision of non-audit services on auditor independence in Saudi Arabia as a part of my Ph.D at Victoria University in Australia. This project is under the supervision of Dr. Albie Brooks.

Your response will be greatly appreciated, and assist me in ensuring my research results are representative and meaningful. I hope this research will be of interest to you, and to the wider academic and professional community.

When complete could you place the completed questionnaire in the reply paid envelope, and return it to me please. We assure you that all responses will be confidential; and individual responses will not be identified. The data will be summarised and only the summarised data, with no identifying features, will be reported in the thesis and any subsequent publications.

Thank you for your participation.

Yours sincerely,

Abdulaziz Aleissa
PhD candidate
Department of accounting and Finance
Victoria University-Australia

Any queries about your participation in this project may be directed to the principal supervisor Dr. Albie Brooks (tel. No: +61-3-96884631) or the researcher Abdulaziz Aleissa (tel. No: +966-508826676). If you have any queries or complaints about the way you have been treated, you may contact the Secretary, University Human Research Ethics Committee, Victoria University, PO Box 14428 MCMC, Melbourne, 8001 (tel. No: +61-3-96884710).

VICTORIA UNIVERSITY OF TECHNOLOGY

إستبانة

دعوة للمشاركين في هذه الإستبانة

السيد / السيدة   المحترم

السلام عليكم و رحمة الله و بركاته

أقدم لك هذه الإستبانه و التي تختص بدراسة آراء مستخدمي القوائم المالية و مراجعى الحسابات في المملكة العربية السعودية في مدى إستقلالية مراجع الحسابات عندما يقدم خدمات إستشارية متنوعة لعميل المراجعة. هذه الإستبانة هي جزء من رسالتي للدكتوراه و التي أنا بصدد إستكمالها في جامعة فكتوريا في استراليا. هذا العمل تحت إشراف الدكتور ألبي بروكس.

إستكمالك لهذه الإستبانة سيكون محل تقديري و سوف يساعدني في الوصول الى نتائج قيمة تخدم الأطراف المعنية. آمل أن تكون هذه الدراسة محل إهتمامك و إهتمام جميع المنتمين لمهنة المحاسبة و المراجعة.

بعد إستكمال هذه الإستبانة آمل إعادة إرسالها مستخدما المظروف المسبق الدفع المرفق. مشاركتك بهذه الإستبانة و البيانات التي سوف تزودنا بها ستكون محل إهتمامي و أؤكد لك على سريتها. هذه البيانات سوف يتم تلخيصها و فقط البيانات الملخصة هي التي سوف يتم إظهارها في البحث أو اي بحوث يتم نشرها مستقبلا.

شكرا لك على مشاركتك و دعمك لمشروع البحث

المخلص

عبدالعزيز العيسى
مرشح لدرجة الدكتوراة
قسم المحاسبة و المالية
جامعة فكتوريا – استراليا

في حالة وجود اية تساؤلات بشأن مشاركتك في هذه الإستبانة نرجوا الإتصال على المشرف على هذه الدراسة الدكتور ألبي بروكس على الرقم التالي ٩٦٨٨٤٦٣١-٣-٦١+ أو على الباحث مباشرة عبدالعزيز العيسى على الرقم ٥٠٨٨٢٦٦٧٦-٩٦٦+. اذا كان لديك اي تساؤل أو شكوى بشأن الطريقة التي عوملت بها من قبل الباحث نرجوا الإتصال على سكرتير لجنة آداب البحث الإنساني على العنوان التالي: جامعة فكتوريا – ص. ب ١٤٤٢٨ أم سي أم سي, ملبورن ٨٠٠١ هاتف رقم ٩٦٨٨٤٧١٠-٣-٦١+

Definitions

Auditor Independence: "freedom from those pressures and other factors that compromise, or can reasonably be expected to compromise, an auditor's ability to make unbiased audit decisions." (ISB 2000)

المصطلحات

إستقلالية المراجع: الحرية من كل الضغوط و غيرها من العوامل التي تؤثر سلبا او من المتوقع أن تؤثر سلبا على قدرة مراجع الحسابات على إبداء رأيه بحيادية تامة.

Non-Audit Services (NAS): All management advisory services, tax and zakat[1] services, bookkeeping services and preparation of financial statements or any service other than audit service.

خدمات غير المراجعة: جميع الخدمات الأستشارية وخدمات الزكاة و الضريبة و مسك الدفاتر المحاسبية و إعدادالقوائم المالية أو أية خدمات أخرى بخلاف خدمات المراجعة السنوية.

Instructions for Completing this Survey

1) Please answer all the survey questions to the best of your ability.
2) All of the statements in the survey are scaled using a number from 1 to 5 as 1 represents "strongly disagree" and 5 represents " strongly agree" . Please complete the survey by CIRCLING the number that you think is most appropriate for each statement.
3) Please write what you would like to add to this survey in the space provided at the end of the survey and advise us if you wish to receive a summary of the findings of the study.
4) Please place the completed survey in the enclosed reply-paid envelope and return it to:

P.O. Box 65429 Riyadh 11556 Saudi Arabia

شرح لكيفية إكمال الإستبانة

١. حاول إجابة جميع الأسئلة بحسب قدرتك.
٢. جميع العبارات في هذه الإستبانة تأخذ القيمة من ١ الى ٥, حيث ١ تمثل لا أوافق بشدة و ٥ تمثل أوافق بشدة, أجب على جميع العبارات بوضع دائرة حول الرقم الذي يتوافق مع رأيك.
٣. أكتب ما تريد إضافته في المكان المخصص في آخر الإستبانة, وإذا كنت تود الحصول على ملخص لنتائج هذه الدراسة أرجو كتابة عنوانك أو بريدك الإلكتروني في آخر الإستبانة .
٤. ضع الإستبانة بعد إستكمالها في المظروف المرفق و أرسله على العنوان التالي:

ص ب ٦٥٤٢٩ الرياض ١١٥٥٦ المملكة العربية السعودية

Thank you for supporting this research project
شكرا على مشاركتك و دعمك لمشروع البحث

[1] Islamic tax

Part 1: Please indicate your level of agreement with the following statements الجزء ١: ضع دائرة حول الرقم الذي يتفق مع رأيك

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
1.1	Auditors have to be independent when performing the audit of their audit clients. يجب أن يكون مراجعوا الحسابات مستقلين تماما عن عملاء المراجعة عند قيامهم بمراجعة حساباتهم.	1	2	3	4	5
1.2	Auditors should be legally allowed to provide non-audit services for their audit clients. يفترض السماح نظاميا لمراجعي الحسابات بتقديم خدمات أخرى غير المراجعة (خدمات إستشارية) لعملاء المراجعة.	1	2	3	4	5
1.3	Auditors can maintain their *Independence* while providing non-audit services to their audit clients. بإمكان مراجعوا الحسابات المحافظة على إستقلاليتهم عند تقديم خدمات المراجعة السنوية بالإضافة للخدمات الأخرى الإستشارية لنفس العميل.	1	2	3	4	5
1.4	Auditors should not undertake work other than audit work for their audit clients. من المفترض على مراجعوا الحسابات الا يقدموا خدمات إستشارية لنفس عميل المراجعة.	1	2	3	4	5
1.5	Auditors should be allowed to provide non-audit services to their audit clients only if the personnel involved are not the same personnel working with the audit team. يفترض السماح لمراجعوا الحسابات بتقديم خدمات إستشارية لعملاء المراجعة بشرط أن يكون فريق العمل الذي يقدم هذه الخدمات مختلف عن فريق العمل الذي يقدم خدمات المراجعة السنوية.	1	2	3	4	5
1.6	**Allowing auditors to provide non-audit services to their audit clients:** **السماح لمراجعي الحسابات بتقديم خدمات إستشارية لعملاء المراجعة:** a) Helps auditors to understand their clients better. يساعدهم لفهم عملائهم بشكل أفضل.	1	2	3	4	5
	b) Helps to perform better audits. يساعدهم لتقديم خدمات مراجعة أفضل.	1	2	3	4	5
	c) Helps auditors to make "better" recommendations that improve their clients' operational effectiveness. يساعدهم لتقديم توصيات أفضل لعملائهم لتطوير مستوى العمل بداخل الشركة.	1	2	3	4	5
	d) Will impair auditor independence. سوف يؤثر سلباعلى إستقلالية مراجع الحسابات.	1	2	3	4	5
	e) Will lower audit fees. سوف يخفض أتعاب المراجعة السنوية.	1	2	3	4	5

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
1.7	**Prohibiting auditors from providing non-audit services for their audit clients will:** **منع مراجعوا الحسابات من تقديم خدمات إستشارية لعملاء المراجعة سوف:** a) Reduce auditors' knowledge about their clients. يقلل من معرفة وفهم المراجع لطبيعة عمل عميل المراجعة.	1	2	3	4	5
	b) Reduce audit quality. يقلل من جودة المراجعة.	1	2	3	4	5
	c) Affect the audit profession negatively. يؤثر على مهنة المراجعة سلبيا.	1	2	3	4	5
	d) Enhance auditor independence. يزيد من إستقلالية المراجع..	1	2	3	4	5
	e) Increase audit fees. يزيد من أتعاب المراجعة.	1	2	3	4	5

Part 2: **Please indicate your level of agreement with the following statements** الجزء ٢: ضع دائرة حول الرقم الذي يتفق مع رأيك

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
2.1	**Auditors should be allowed to provide non-audit services to their audit clients if:** **من المفترض السماح لمراجعي الحسابات بتقديم خدمات إستشارية لعميل المراجعة إذا كان:** a) Total non-audit services (NAS) fee from incumbent audit client ≥ 100% audit fee. أجمالي أتعاب الخدمات الأستشارية المقدمة لعميل المراجعة أكبر من أو تساوي ١٠٠% من إجمالي أتعاب المراجعة السنوية لنفس العميل.	1	2	3	4	5
	b) Total NAS fee from incumbent audit client ≥ 50% audit fee. أجمالي أتعاب الخدمات الأستشارية المقدمة لعميل المراجعة أكبر من أو تساوي ٥٠% من إجمالي أتعاب المراجعة السنوية لنفس العميل.	1	2	3	4	5
	c) Total NAS fee from incumbent audit client ≥ 25% audit fee. أجمالي أتعاب الخدمات الأستشارية المقدمة لعميل المراجعة أكبر من أو تساوي ٢٥% من إجمالي أتعاب المراجعة السنوية لنفس العميل.	1	2	3	4	5
	d) Total NAS fee from incumbent audit client ≥ 10% audit fee. أجمالي أتعاب الخدمات الأستشارية المقدمة لعميل المراجعة أكبر من أو تساوي ١٠% من إجمالي أتعاب المراجعة السنوية لنفس العميل.	1	2	3	4	5
	e) Total NAS fee from incumbent audit client ≥ 0% audit fee. أجمالي أتعاب الخدمات الأستشارية المقدمة لعميل المراجعة أكبر من أو تساوي ٠% من إجمالي أتعاب المراجعة السنوية لنفس العميل.	1	2	3	4	5
	f) Total NAS fee from incumbent audit client ≥ 25% of total audit firm revenues. أجمالي أتعاب الخدمات الأستشارية من أحد العملاء أكبر من أو تساوي ٢٥% من إجمالي إيرادات مكتب المراجعة في نفس السنة.	1	2	3	4	5

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
	g) Total NAS fee from incumbent audit client ≥ 10% of total audit firm revenues. أجمالي أتعاب الخدمات الأستشارية من أحد العملاء أكبر من أو تساوي ١٠% من إجمالي إيرادات مكتب المراجعة في نفس السنة.	1	2	3	4	5
2.2	Overdue **immaterial** non-audit fees may impair auditor independence. التأخير في دفع مستحقات المراجع **المادية الغير جوهرية** مقابل تقديم خدمات إستشارية لأحد عملاء المراجعة يقلل من إستقلاليته.	1	2	3	4	5
2.3	Overdue **material** non-audit fees may impair auditor independence. التأخير في دفع مستحقات المراجع **المادية الجوهرية** مقابل تقديم خدمات إستشارية لأحد عملاء المراجعة تقلل من إستقلاليته.	1	2	3	4	5
2.4	Audit clients that demand non-audit services have more power over auditors. عملاء المراجعة الذين يطلبون خدمات إستشارية من مراجعيهم القانونيين يكونون اكثر تحكما في سير عملية المراجعة من المراجعين أنفسهم.	1	2	3	4	5
2.5	Auditors who disagree with their clients' position are likely to lose those clients. المراجعون القانونيون الذين لا يتفقون مع عملاء المراجعة يكونون عرضة لفقد هؤلاء العملاء.	1	2	3	4	5
2.6	Overdue audit fees may not impair auditor independence. التأخير في دفع مستحقات المراجع الخاصة بأتعاب المراجعة السنوية من أحد عملاء المراجعة (تقادم الأتعاب) لا تقلل من إستقلالية المراجع عند تقديمة لخدمات المراجعة لنفس العميل في المستقبل.	1	2	3	4	5

Part 3: **Please indicate your level of agreement with the following statements** **الجزء ٣: ضع دائرة حول الرقم الذي يتفق مع رأيك**

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
3.1	Audit firms should be allowed to provide financial accounting and reporting services for their audit clients. من المفترض السماح لمراجعي الحسابات بتقديم خدمات محاسبية خاصة بإعداد القوائم المالية لعميل المراجعة.	1	2	3	4	5
3.2	**In addition to the audit, an audit firm can maintain its independence when providing the following services for its client:** **بالإضافة لتقديم خدمات المراجعة السنوية لعميل المراجعة, المراجع بإمكانه المحافظة على إستقلاليته عند تقديمه خدمات محاسبية و إستشارية مثل:** a) Maintaining the journals and ledgers. خدمات مسك الدفاتر "اليومية و الأستاذ العام" لعميل المراجعة.	1	2	3	4	5
	b) Making adjusting entries. القيام بعمل قيود التسوية لحسابات عميل المراجعة.	1	2	3	4	5
	c) Preparing financial statements. إعداد و تجهيز الحسابات الختامية لعميل المراجعة.	1	2	3	4	5
	d) Preparing the executive payroll. إعداد جداول رواتب إداريي عميل المراجعة.	1	2	3	4	5
	e) Maintaining selected general ledger accounts in a private ledger. مسك دفاتر أستاذ لحسابات معينة لعميل المراجعة.	1	2	3	4	5

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
3.3	**Intangible asset values included in the financial accounts should be prepared by:** **قيم الأصول الغير ملموسة الخاصة بشركة ما يجب أن تعد من قبل:** a) Staff and directors of the companies concerned. موظفي و مديري الشركة المعنية.	1	2	3	4	5
	b) Intangible asset valuers working for the company's external auditor. مختصين بتقييم الأصول الغير ملموسة يعملون لدى المراجع الخارجي للشركة المعنية.	1	2	3	4	5
	c) Independent third party intangible asset valuers. طرف ثالث مستقل عن الشركة و عن المراجع الخارجي..	1	2	3	4	5
3.4	**Auditor independence may be impaired when:** **إستقلالية المراجع الخارجي قد تضعف عندما تكون:** a) Fees received from incumbent audit client for only accounting and reporting services ≥ 50% audit fees. أتعاب خدمات متعلقة بالمحاسبة و إعداد القوائم المالية مقدمة لعميل المراجعة اكبر من او تساوي ٥٠% من أتعاب المراجعة لنفس العميل.	1	2	3	4	5
	b) Fees received from incumbent audit client for only accounting and reporting services ≥ 25% audit fees. أتعاب خدمات متعلقة بالمحاسبة و إعداد القوائم المالية مقدمة لعميل المراجعة اكبر من او تساوي ٢٥% من أتعاب المراجعة لنفس العميل.	1	2	3	4	5
	c) Fees received from incumbent audit client for only accounting and reporting services ≥ 10% audit fees. أتعاب خدمات متعلقة بالمحاسبة و إعداد القوائم المالية مقدمة لعميل المراجعة اكبر من او تساوي ١٠% من أتعاب المراجعة لنفس العميل.	1	2	3	4	5

Part 4: Please indicate your level of agreement with the following statements **الجزء ٤ : ضع دائرة حول الرقم الذي يتفق مع رأيك**

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
4.1	An audit firm's primary responsibility is to safeguard the shareholders' interest. مسؤلية المراجع الخارجي لشركة ما تتمثل في المحافظة على حقوق مساهمي هذه الشركة.	1	2	3	4	5
4.2	An audit firm's primary responsibility is to act as an advocate for its client. مسئولية المراجع الخارجي لشركة ما تتمثل في الدفاع عن حقوق هذه الشركة.	1	2	3	4	5
4.3	Auditors should be allowed to assist their audit clients in making decisions for complex transactions. من المفترض السماح لمراجع الحسابات الخارجي بمساعدة عميل المراجعة في إتخاذ قرارات خاصة بالعمليات المحاسبية المعقدة.	1	2	3	4	5
4.4	In general, assisting an audit client in making decisions does NOT impair auditor independence. بصفة عامة، مساعدة عميل المراجعة في إتخاذ القرارات المتعلقة بالشركة لا تضعف من إستقلالية المراجع.	1	2	3	4	5
4.5	Assisting an audit client in making decisions is different from making those decisions. مساعدة عميل المراجعة في إتخاذ قرارات متعلقة بالشركة يختلف عن إتخاذ القرار نفسه.	1	2	3	4	5

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
4.6	Providing tax and zakat services to an audit client makes the audit firm act as an advocate for its client. تقديم خدمات محاسبية عن الزكاة و الضريبة لعميل المراجعة يجعل من مراجع الحسابات يبدو و كأنه محامي و مدافع عن حقوق الشركة.	1	2	3	4	5
4.7	In general, providing NAS, including tax and zakat services to an audit client does not involve any decision-making. بصفة عامة, تقديم خدمات إستشارية و محاسبية و زكاة و ضريبة لعميل المراجعة ليس له علاقة بعملية إتخاذ القرار في الشركة محل المراجعة.	1	2	3	4	5
4.8	Providing tax and zakat services to an audit client impairs auditor independence. تقديم خدمات محاسبية خاصة بالضريبة و الزكاة لعميل المراجعة تضعف من إستقلالية المراجع.	1	2	3	4	5
4.9	**Auditor independence may be impaired when:** **إستقلالية المراجع الخارجي قد تضعف عندما تكون:** a) Fees received for tax and zakat services provided to an incumbent audit client $\geq 50\%$ of audit fees. أتعاب خدمات الزكاة و الضريبة فقط و المقدمة لعميل المراجعة تمثل ٥٠% أو أكثر من أتعاب المراجعة ككل.	1	2	3	4	5
	b) Fees received for tax and zakat services provided to an incumbent audit client $\geq 25\%$ of audit fees. أتعاب خدمات الزكاة و الضريبة فقط و المقدمة لعميل المراجعة تمثل ٢٥% أو اكثر من أتعاب المراجعة ككل.	1	2	3	4	5
	c) Fees received for tax and zakat services provided to an incumbent audit client $\geq 10\%$ of audit fees. أتعاب خدمات الزكاة و الضريبة فقط و المقدمة لعميل المراجعة تمثل ١٠% أو أكثر من أتعاب المراجعة ككل.	1	2	3	4	5

Part 5: **Please indicate your level of agreement with the following statements** **الجزء ٥: ضع دائرة حول الرقم الذي يتفق مع رأيك**

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
5.1	Providing NAS to an audit client may create a **personal relationship** between the auditor and the client. تقديم خدمات إستشارية لعميل المراجعة قد يخلق **علاقة شخصية** بين المراجع وعميل المراجعة.	1	2	3	4	5
5.2	Providing NAS to an audit client may create a **professional relationship** between the auditor and the client. تقديم خدمات إستشارية لعميل المراجعة قد يخلق **علاقة مهنية فقط** بين المراجع و عميل المراجعة.	1	2	3	4	5
5.3	Providing NAS to an audit client may create a **professional and amicable relationship** between the auditor and the client. تقديم خدمات إستشارية لعميل المراجعة قد يخلق **علاقة مهنية** و **صداقة ايضا** بين المراجع و عميل المراجعة.	1	2	3	4	5
5.4	Providing NAS to an audit client may create a **professional but distant relationship** between the auditor and the client. تقديم خدمات إستشارية لعميل المراجعة قد يخلق **علاقة مهنية ولكنها علاقة متباعدة لا تمتد الى صداقة** بين المراجع و عميل المراجعة.	1	2	3	4	5
5.5	Auditors give more trust to their audit clients with whom they have a close personal relationship. تزداد ثقة مراجع الحسابات لعميل المراجعة عندما تكون هناك علاقة شخصية قوية بين الطرفين.	1	2	3	4	5

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
5.6	Any relationship created between an auditor and his audit client may increase the auditor's trust in the client. عندما تكون هناك علاقة (بصفة عامة) بين المراجع و عميل المراجعة تزداد ثقة المراجع بعميل المراجعة.	1	2	3	4	5
5.7	Recruiting top managers to an audit client may create a personal relationship between the audit firm and its audit client. إختيار و تعيين مديري الإدارات العليا لشركة ما عن طريق المراجع الخارجي لهذه الشركة قد يخلق علاقة شخصية بين المراجع و هؤلاء المدراء.	1	2	3	4	5
5.8	A specific relationship between an auditor and the client tempts an auditor to subordinate his professional judgment despite all the sanctions to the contrary. وجود نوع من العلاقة الخاصة بين المراجع و عميل المراجعة يؤدي الى قيام المراجع بالإعتماد على ما يراه عميل المراجعة حتى و إن كان مخالف لما يراه المراجع نفسه.	1	2	3	4	5
5.9	Recruiting top managers to an audit client may reduce effectiveness of future audits of that client. إختيار و تعيين مديري الإدارات العليا لشركة ما عن طريق المراجع الخارجي لهذه الشركة قد يشكك من كفاءة مخرجات المراجعة لنفس العميل.	1	2	3	4	5
5.10	Auditor independence may be compromised when audit firm provide recruitment of top managers to its audit clients. إستقلالية المراجع قد تتاثر سلبا عندما يتم إختيار و تعيين مدراء الإدارات العليا لشركة ما عن طريق مراجع الحسابات القانوني لهذه الشركة.	1	2	3	4	5

Part 6: Please indicate your level of agreement with the following statements **الجزء ٦: ضع دائرة حول الرقم الذي يتفق مع رأيك**

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
6.1	Audit firms should be prohibited from providing NAS to their audit clients. يجب منع مراجعوا الحسابات من تقديم اي خدمات أخرى لعميل المراجعة خلاف خدمات المراجعة السنوية المتعارف عليها.	1	2	3	4	5
6.2	When auditors are allowed to provide NAS to their audit client, public companies should be required by law to disclose non-audit fees paid to their auditors. في حالة السماح لمراجعي الحسابات بتقديم خدمات إستشارية لعملاء المراجعة, يفرض على الشركات المساهمة أن تفصح عن المبالغ التي دفعتها مقابل أتعاب خدمات إستشارية مقدمة لها من مراجع الحسابات القانوني.	1	2	3	4	5
6.3	Public companies should be required by law to disclose non-audit fees paid to NAS providers other than their external auditors. يفرض على الشركات المساهمة أن تفصح عن المبالغ التي دفعتها مقابل أتعاب خدمات إستشارية مقدمة لها من محاسب قانوني آخر غير المحاسب القانوني للشركة.	1	2	3	4	5
6.4	Public companies should be required by law to disclose audit fees paid to their auditors. يجب أن يفرض على الشركات المساهمة أن تفصح عن المبالغ التي دفعتها كأتعاب لخدمات المراجعة السنوية.	1	2	3	4	5
6.5	Disclosing audit and non-audit fees strengthens auditor independence. الإفصاح عن أتعاب المراجعة و أتعاب و الخدمات الإستشارية المقدمة من المراجع الخارجي يزيد من إستقلالية المراجع.	1	2	3	4	5

	Statements العبارات	Strongly disagree لا أوافق بشدة	Disagree لا أوافق	Neutral محايد	Agree أوافق	Strongly agree أوافق بشدة
6.6	The annual financial statements should include a management report which discloses the nature of other services provided by the external auditor القوائم المالية يجب ان تشتمل على تقرير من مجلس الإدارة يوضح جميع الخدمات التي حصلت عليها الشركة من المراجع الخارجي .	1	2	3	4	5
6.7	Audit committee must approve all permitted NAS to be provided by the auditor before the services are provided يجب أن توافق لجنة المراجعة أولا على جميع الخدمات الإستشارية التي ستحصل عليها الشركة من المراجع الخارجي قبل البدء في تقديم مثل هذه الخدمات.	1	2	3	4	5
6.8	Audit firms should be prohibited from providing financial accounting and reporting service to their audit clients يجب منع مراجعوا الحسابات من تقديم اي نوع من الخدمات المحاسبة مثل مسك الدفاتر و إعداد القوائم المالية لعميل المراجعة.	1	2	3	4	5
6.9	Audit firms should be prohibited from providing tax and zakat services to their audit clients. يجب منع مراجعوا الحسابات من تقديم خدمات الزكاة و الضريبة لعملاء المراجعة.	1	2	3	4	5
6.10	Audit firms should be prohibited from offering formal, paid executive recruiting services to their audit clients يجب منع مراجعوا الحسابات من تقديم خدمات إختيار و تعيين مدراء الإدارات لعملاء المراجعة.	1	2	3	4	5
6.11	**Auditor independence will be impaired when:** **إستقلالية المراجع تقل أو تضعف عندما تكون:** a) The company's internal auditors perform the internal audit function. مراجع الشركة الداخلي هو من يقوم بعملية المراجعة الداخلية.	1	2	3	4	5
	b) The company's external auditor, same personnel, perform the internal audit function مراجع الشركة الخارجي هو من يقوم بعملية المراجعة الداخلية.	1	2	3	4	5
	c) The company's external auditor, different personnel, perform the internal audit function المراجع الخارجي للشركة و لكن مراجعون مختلفون عن الذين يقومون بعملية المراجعة السنوية هم ن يقومون بعملية المراجعة الداخلية لعميل المراجعة.	1	2	3	4	5
	d) Internal audit function is outsourced to another external auditor. مراجع خارجي آخر "خلاف المراجع الخارجي للشركة" هو من يقوم بعملية المراجعة الداخلي.	1	2	3	4	5
6.12	Audit firms should have certain procedures and suitable measures to maintain their independence. يجب على مكاتب المحاسبة وضع سياسات و إجراءات و مقاييس خاصة لقياس مدى إستقلالية فريق العمل عن عميل المراجعة.	1	2	3	4	5
6.13	Investor selection of auditors enhances auditor independence. إختيار مراجع الحسابات الخارجي من قبل ملاك الشركة يعزز من إستقلالية هذا المراجع.	1	2	3	4	5
6.14	Public companies should not offer a job to their external auditors or their personnel. يجب على الشركات المساهمة عدم تقديم فرص وظيفية للمراجع او من يعمل معه في مراجعة حسابات الشركات الا بعد مرور مدة معينة على ترك العمل لدى شركة المراجعة تقدر بسنتين على الأقل.	1	2	3	4	5

Section 7: General Questions (Demography) الجزء ٧: أسئلة عامة

1- Gender/ الجنس?

❑	Male "ذكر"
❑	Female "أنثى"

2- In which of the following age groups do you belong? لأي المجموعات تنتمي من ناحية العمر؟

❑	Under 25 "أقل من ٢٥ سنة"	❑	35-44	❑	55-64
❑	25-34	❑	45-54	❑	Over 64

3- What is your occupation? ماهي وظيفتك الحالية ؟

❑ a) Auditor from the Big 5 ❑ مراجع حسابات في إحدى شركات المحاسبة الخمس الكبرى	❑ c) Loan officer ❑ مسؤول قروض شركات	❑ e) Financial director or accounting manager ❑ مدير مالي او رئيس حسابات لإحدى الشركات المساهمة
❑ b) Auditor from the non-Big 5 ❑ مراجع حسابات في إحدى شركات المحاسبة غير الخمس الكبرى	❑ d) Financial analyst ❑ محلل مالي	❑ f) Academic ❑ أكاديمي
❑ Other "أخرى"		

If you answer c, d, or e go to question 4; otherwise, go to question 5

إذا كانت إجابتك c ,d أو e إنتقل الى السؤال الرابع, و إذا لم تكن كذلك إنتقل الى السؤال الخامس

4- In which industry is your company involved? لاي المجالات تنتمي الشركة التي تعمل بها ؟

❑	Banking بنوك	❑	Industrial صناعة	❑	Telecom إتصالات	❑	Cement أسمنت
❑	Services خدمات	❑	Electrical كهرباء	❑	Agriculture زراعة	❑	Insurance تأمين

5- Please indicate the highest level of education achieved ماهي الدرجة العملية التي تحملها حاليا ؟

❑	High school ثانوية عامة	❑	2-year Diploma دبلوم "سنتين"	❑	Bachelor بكالورس
❑	Master ماجستير	❑	Doctoral دكتوراة	❑	Other أخرى

6- Total number of accounting courses you have taken ماهو عدد المقررات المحاسبية التي درستها ؟

❑	Less than 3 courses أقل من ٣ مقررات	❑	Between 7 and 9 courses بين ٧ و ٩ مقررات
❑	Between 3 and 6 courses بين ٣ و ٦ مقررات	❑	More than 9 courses أكثر من ٩ مقررات

7- What are your professional certifications? Tick mo

ما هي الشهادات المهنية التي تحملها حاليا "بإمكانك التأشير على اكثر من خيار" ؟

❑ SOCPA "Saudi CPA" ❑ زمالة المحاسبين السعودية	❑ CIA "Certified Internal Auditor" ❑ زمالة المراجعين الداخليين
❑ CPA "US CPA" ❑ زمالة المحاسبين الامريكية	❑ CMA "Certified Management Accountant" ❑ زمالة المحاسبين الإداريين
❑ Other, please indicate أخرى	

8- Where did you achieve the highest level of education? من أين حصلت على آخر شهادة علمية ؟

❑	Saudi Arabia السعودية	❑	USA امريكا	❑	Europe أوروبا
❑	Australia أستراليا	❑	Other, please indicate اخرى		

9- How many years have you been in your present occupation? كم عدد السنوات التي قضيتها في عملك الحالي؟

❑	Less than 5	❑	11-15	❑	21-25
❑	5-10	❑	16-20	❑	More than 25

Would you like to receive a copy of the results of this study? Yes ☐ No ☐

هل تود أن تحصل على نسخة من نتائج هذه الدراسة نعم ☐ لا ☐

(If yes, please provide your preferred email or postal address)

إذا كانت الإجابة نعم, أمل كتابة البريد الإلكتروني أو العنوان البريدي

Thank you very much for taking the time to complete this survey. Your help in providing this information is greatly appreciated. If there is anything else you would like to tell us about please do so in the space provided below.

شكرا لك على إمضاء جزء من وقتك لإستكمال هذه الإستبانة. مساعدتك و توفيرك لهذه البيانات محل تقديري و إذا كان لديك أية معلومات أخرى تود إضافتها, ارجو إستخدام المساحة المتبقية لكتابة ما تريد إضافته.

Thank you for your time and co-operation in completing this survey

أشكرك على وقتك و تعاونك وعلى إكمالك لهذه الإستبانة

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Appendix II: References of the Questionnaire Statements

Section 1

	Statements	References
1.1	Auditors have to be independent when performing the audit of their audit clients	Hussey (1999), Schulte (1965), Beattie et al, (1999), Hartley and Ross (!972)
1.2	Auditors should be legally allowed to provide NAS for their audit clients	Hussey (1999), Schulte (1965)
1.3	Auditors can maintain their *independence* while providing NAS to their audit clients	Hussey (1999), Schulte (1965)
1.4	Auditors should not undertake work other than audit work for their audit clients	Titard (1971), Hussey (1999)
1.5	Auditors should be allowed to provide NAS to their audit clients only if the personnel involved are not the same personnel working with the audit team.	Sori and Karbhari (2005)
1.6	Allowing auditors to provide NAS for their audit clients: a) helps them to understand their clients better	Thornton et al. (2003)
	b) helps to perform better audits	Thornton et al. (2003)
	c) helps them to make "better" recommendations that improve their clients' operational effectiveness	Thornton et al. (2003)
	d) will impair auditor independence	Thornton et al. (2003)
	e) will lower audit fees	Thornton et al. (2003)
1. 7	Prohibiting auditors from providing NAS for their audit clients will: a) reduce their knowledge about their clients	Thornton et al. (2003)
	b) reduce audit quality	Thornton et al. (2003)
	c) affect the audit profession negatively	Thornton et al. (2003)
	d) enhance auditor independence	Thornton et al. (2003)
	e) increase audit fees	Thornton et al. (2003)

Section 2:

	Statements	References
2.1	Auditors should NOT be allowed to provide NAS to their audit clients if: a) total NAS fee from incumbent audit client ≥ 100% audit fee	Beattie et al. (1999) and Shaub (2004) Chung and Kallaur (2003) Thornton et al. (2003)
	b) total NAS fee from incumbent audit client ≥ 50% audit fee	Beattie et al. (1999) and Shaub (2004) Thornton et al. (2003)
	c) total NAS fee from incumbent audit client ≥ 25% audit fee	Beattie et al. (1999) and Shaub (2004) Thornton et al. (2003)
	d) total NAS fee from incumbent audit client ≥ 10% audit fee	Beattie et al. (1999) and Shaub (2004) Pany and Rechers (1980)
	e) total NAS fee from incumbent audit client ≥ 0% audit fee	Beattie et al. (1999) and Shaub (2004)
	f) total NAS fee from incumbent audit client ≥ 25% of total audit firm revenues	Beattie et al. (1999) and Shaub (2004)
	g) total NAS fee from incumbent audit client ≥ 10% of total audit firm revenues	Shaub (2004)

Statement		Reference
2.2	Overdue immaterial non-audit fees may impair auditor independence	Agacer and Doupnik (1991),Gorman and Ansong (1998), Hudaib (2003)
2.3	Overdue material non-audit fees may impair auditor independence.	Agacer and Doupnik (1991),Gorman and Ansong (1998), Hudaib (2003)
2.4	Audit clients that demand non-audit services have more power over auditors	Thornton, J., Reinstein, A. and Miller, C., (2003)
2.5	Auditors who disagree with their clients' position are likely to lose that client	Thornton, J., Reinstein, A. and Miller, C., (2003)
2.6	Overdue audit fees may not impair auditor independence	Agacer and Doupnik (1991),Gorman and Ansong (1998), Hudaib (2003)

Section 3:

Statements		References
3.1	Audit firms should be allowed to provide financial accounting and reporting services for their audit clients.	Lavin (1976), Firth (1981)
3.2	In addition to the audit, an audit firm can maintain its independence when providing the following services for its client: a) maintaining the journals and ledgers	Lavin (1976)
	b) making adjusting entries	Lavin (1976)
	c) preparing financial statements	Lavin (1976)
	d) preparing the executive payroll	Lavin (1976)
	e) maintaining selected general ledger accounts in a private ledger	Lavin (1976)
3.3	Intangible asset values included in the financial accounts should be prepared by: a) staff and directors of the companies concerned	Lavin (1976), Thornton, J., Reinstein, A. and Miller, C., (2003)
	b) intangible asset valuers working for the company's external auditor	Thornton, J., Reinstein, A. and Miller, C., (2003)
	c) independent third party intangible asset valuers	Thornton, J., Reinstein, A. and Miller, C., (2003)
3.4	Auditor independence may be impaired when: a) fees received from incumbent audit client for only accounting and reporting services ≥ 50% audit fees	Shaub (2004)
	b) fees received from incumbent audit client for only accounting and reporting services ≥ 25% audit fees	Shaub (2004)
	c) fees received from incumbent audit client for only accounting and reporting services ≥ 10% audit fees	Shaub (2004)

Section 4:

	Statements	References
4.1	An audit firm's primary responsibility is to safeguard the public interest.	Jenkins and Lowe (1999)
4.2	An audit firm's primary responsibility is to act as an advocate for its client.	Jenkins and Lowe (1999)
4.3	Auditors should be allowed to assist their audit clients in making decisions for complex transactions.	Bartlett (1993)
4.4	In general, assisting an audit client in making decisions does NOT impair auditor independence.	Bartlett (1993), Siegel and McGrath (2003), Lowe, Geiger and Pany (1999)
4.5	Assisting an audit client in making decisions is different from making those decisions.	Bartlett (1993), Siegel and McGrath (2003), Lowe, Geiger and Pany (1999)
4.6	Providing tax and zakat services to an audit client makes the audit firm act as an advocate for its client.	Siegel and McGrath (2003), Lowe, Geiger and Pany (1999)
4.7	In general, providing NAS, including tax and zakat services to an audit client does not involve any decision-making.	Hudaib (2003), Shaub (2004)
4.8	Providing tax and zakat services to an audit client impairs auditor independence	Hudaib (2003), Shaub (2004)
4.9	Auditor independence may be impaired when: a) fees received for tax and zakat services provided to an incumbent audit client $\geq 50\%$ of audit fees	Shaub (2004)
	b) fees received for tax and zakat services provided to an incumbent audit client $\geq 25\%$ of audit fees	Shaub (2004)
	c) fees received for tax and zakat services provided to an incumbent audit client $\geq 10\%$ of audit fees	Shaub (2004)

Section 5:

	Statements	References
5.1	Providing NAS to an audit client may create a personal relationship between the auditor and the client.	Shaub (2004) and Hussey (1999)
5.2	Providing NAS to an audit client may create a professional relationship between the auditor and the client.	Shaub (2004) and Hussey (1999)
5.3	Providing NAS to an audit client may create a professional and amicable relationship between the auditor and the client.	Shaub (2004) and Hussey (1999)
5.4	Providing NAS to an audit client may create a professional but distant relationship between the auditor and the client.	Shaub (2004) and Hussey (1999)
5.5	Auditors give more trust to their audit clients with whom they have a close personal relationship.	Shaub (2004) and Hussey (1999)
5.6	Any relationship created between an auditor and his audit client may increase the auditor's trust in the client.	Shaub (2004) and Hussey (1999)
5.7	Recruiting top managers to an audit client may create a personal relationship between the audit firm and its audit client.	Quick and Warmig-Rasmussen (2005)
5.8	A specific relationship between an auditor and the client tempts an auditor to subordinate his professional judgment despite all the sanctions to the contrary	Bartlett (1993)
5.9	Recruiting top managers to an audit client may reduce effectiveness of future audits of that client	Imhoff (1978), Koh and Mahathevan (1993)
5.10	Auditor independence may be compromised when audit firm provide recruitment of top managers to its audit clients	Imhoff (1978), Koh and Mahathevan (1993)

Section 6:

Statements		References
6.1	Audit firms should be prohibited from providing NAS to their audit clients.	Titard (1971), Sori and Karbhari (2005)
6.2	When auditors are allowed to provide NAS to their audit client, public companies should be required by law to disclose non-audit fees paid to their auditors.	Schleifer and Shockley (1990) Canning, M. and Gwilliam, D. (1999) Sori and Karbhari (2005)
6.3	Public companies should be required by law to disclose non-audit fees paid to NAS providers other than their external auditors	Canning, M. and Gwilliam, D. (1999)
6.4	Public companies should be required by law to disclose audit fees paid to their auditors	Sori and Karbhari (2005)
6.5	Disclosing audit and non-audit fees strengthens auditor independence.	Sori and Karbhari (2005)
6.6	The annual financial statements should include a management report which discloses the nature of other services provided by its external auditor	Schleifer and Shockley (1991), Sori and Karbhari (2005)
6.7	Audit committee must approve all permitted NAS to be provided by the auditor before the services are provided	The Sarbanes-Oxley Act (2002)
6.8	Audit firms should be prohibited from providing financial accounting and reporting service to their audit clients	Shockley (1981), USA
6.9	Audit firms should be prohibited from providing tax and zakat services to their audit clients.	Hartley and Ross (1972)
6.10	Audit firms should be prohibited from offering formal, paid executive recruiting services to their audit clients	Imhoff (1978), Koh and Mahathevan (1993)
6.11	Auditor independence will be impaired when: a) The company's internal auditors perform the internal audit function.	Canning and Gwilliam (1999)
	b) The company's external auditor, same personnel, perform the internal audit function	Canning and Gwilliam (1999)
	c) The company's external auditor, different personnel, perform the internal audit function	Canning and Gwilliam (1999)
	d) Internal audit function is outsourced to another external auditor.	Canning and Gwilliam (1999)
6.12	Audit firms should have certain procedures and suitable measures to maintain their independence.	ISB (2000),
6.13	Investor selection of auditors enhances auditor independence.	Mayhew and Pike (2004)
6.14	Public companies should not offer a job to their external auditors or their personnel.	Imhoff (1978), Koh and Mahathevan (1993)

Appendix III: Selected Empirical Studies

Selected Empirical Studies of NAS and perceptions of auditor independence

Author and Country	Participants	Response rate	Research Method	Factors Investigated	Major findings
Schulte (1965), USA	Financial Executives Largest institutions n=504 Randomly selected institutions n=756	56% 51%	Survey - Mail questionnaire	MAS in general	-Acting as a management consultant suggested a conflict of interest to 33%. -43% did not think so. -Conflict of interest represents a serious factor about audit independence.
Briloff (1966), USA	Financial community Accounting professionals n=200	72% 64%	Survey – Mail questionnaire	NAS in general and A list of different NAS.	58% of the financial community: NAS is incompatible with independence. 22% of the accounting profession: NAS is incompatible with independence 22%
Titard (1971) USA	Users of financial statements (n=223)	71.7%	Survey – Mail questionnaire	MAS in general 33 specific types of NAS	49% perceived that auditor independence might be at risk if one or more NAS was provided. 42% agreed with total prohibition if MAS if there is no separation of staff.

Author and Country	Participants	Response rate	Research Method	Factors Investigated	Major findings
Lavin (1976) USA	Three groups: Auditors (n=346) Loan officers (n=326) Financial analysts (n=175)	58% 35% 42%	Survey – Mail questionnaire	A list of different auditor-client relationships	Financial relationship and providing accounting related services affects auditor independence
Firth (1980) UK	Big 8 CPAs (n=173) Non-big 8 CPAs n=136) Other CPAs (n=191) Financial analysts (n=120) Loan officers (n=130)	53% 51% 47% 57% 54%	Survey – Mail questionnaire	29 auditor-client relationships including NAS	Significant differences between groups
Dykxhoorn & Sinning (1981) Germany	Auditors (n=380)	28.4%	Survey – Mail questionnaire	A list of different auditor-client relationships	Providing accounting services affects auditor independence but not significantly
Shockley (1981), USA	Big 8 auditors (n= 77) Non-big 8 auditors (n=69) Loan officers (n=67) Financial analysts (n=64)	62% 64% 67% 61%	Survey - Mail questionnaire	MAS (designing and installation of accounting systems)	Firms providing MAS were perceived as having a higher risk of impairment of independence
Reckers and Stagliano (1981), USA	Financial analysts Sophisticated n = 50 Non-sophisticated (MBA students) n = 50	100%	Survey - Mail questionnaire	A list of non-audit services	Users have confidence in the CPA's objective judgment. SEC's decision to require disclosure rather than prohibit NAS provision was appropriate

Author and Country	Participants	Response rate	Research Method	Factors Investigated	Major findings
Pany and Reckers (1983), USA	Board of directors (n=600)	15.3%	Survey – mail questionnaire	Tax preparation Acquisition review Systems design	Auditor independence is affected by the type of MAS and the percentage of fees
Pany and Reckers (1984), USA	Financial analysts (n=200). Stockholders (n=200)	33.5% 23%	Survey - Mail questionnaire	The role of auditors Separation of staff A list of NAS	Separation of staff decrease Independence concerns No differences in perceptions between the services.
Knapp (1985) USA	Senior loan officers (n=70)	61.4%	Survey - Mail questionnaire	MAS in general	MAS is a considered factor but not a major one
McKinley, Pany, and Reckers (1985), USA	Loan officers (n=900).	29%	Survey - Mail questionnaire	MAS in general	No significant influence on auditor independence
Pany and Reckers (1988), USA	Loan officers (n=192) Financial analysts (n=104)		Survey - Mail questionnaire	Internal control system	Little influence
Gul (1989), Australia	Loan offers (n=49)	76%	Survey - Mail questionnaire	Design and installation of some accounting systems	Increase auditor independence
Lindsay (1990), Canada	Loan officers (n=55)	69%	Survey - Mail questionnaire	MAS provision in general	Negative effect on auditor independence
Wines (1994), Australia	76 Companies		Archival	Levels of NAS fee and the type of audit opinion	Negative effect Unqualified report is positively correlated with high NAS fee to total fees

Author and Country	Participants	Response rate	Research Method	Factors Investigated	Major findings
Bartlett (1993), USA	Auditors (n= 300) Bankers (n= 300)	48% 33%	Survey – Mail questionnaire	A list of NAS	Join venture arrangements with audit clients severely reduced auditor independence
Lowe and Pany (1995), USA	Loan officers (n=2100)	19%	Survey - Mail questionnaire	Type of business relationship Staff separation Materiality and Continuity of engagement	Type of relationship do not affect auditor independence Negative influence with no separation Higher degree of perception with separation of staff.
Lowe and Pany (1996), USA	Financial analyst (n=2100)	14.5%	Survey - Mail questionnaire	Type of business relationship Staff separation Materiality	Results were consistent with the 1995 study.
Teoh and Lim (1996), Malaysia	Auditors (n=100) CPAs from industry (n=100)	69% 33%	Survey – Mail questionnaire	MAS in general	Negative influence
Barltlett (1997), USA	Loan officers (n= 150) Auditors (n= 150)	51% 32%	Survey – Mail questionnaire	A purchase investigation audit that gives rise to a self-review threat	Loan officers perceived negative effect Auditors did not perceive negative effect Significant differences in perceptions between loan officers and auditors
Beattie, Brandt and Fearnley (1998), UK	Financial journalists (n= 50)	36%	Survey – Mail questionnaire	NAS in general	NAS is the second serious threat to auditor independence when NAS fees at a level of 100% of audit fees Less negative effect when it is at a level of 50%

Author and Country	Participants	Response rate	Research Method	Factors Investigated	Major findings
Beattie, Brandt and Fearnley (1999), UK	Audit partners (n= 304) Financial directors (n= 300) Financial journalists (n= 50)	51% 80% 36%	Survey – Mail questionnaire	MAS in general	Economic dependence negatively affects auditor independence
Hussey (1999), UK	Financial directors (n= 3000)	25.9	Survey – Mail questionnaire	MAS in general	The majority agreed with allowing auditors to undertake work other than audit
Lowe, Geiger and Pany (1999), USA	Loan officers (n= 1000)	17.7%	Survey – Mail questionnaire	Outsourcing internal audit	Negative effect if outsourced to the external auditor Positive effect if there is separation of staff
Canning and Gwilliam (1999), Ireland	Corporate lenders Investment managers Financial analysts (n=196)	75.5%	Mail questionnaire and semi-structured interview	MAS in general	Negatively effected if no separation of staff No effect if there is separation of staff No effect if there is full disclosure
Patel and Psarose (2000), UK, Australia, Malaysia and India	Students (n= 298)		Experiment	Design and installation of accounting system	Negative effect for UK, Australia, and Malaysia with no significant differences. For India, no significant negative effect
Jenkins and Krawczyk (2002) USA	Big 5 auditors (n=83) Non-big 5 auditors (n= 139) Investors (n= 101)		Experiment	A list of NAS	NAS provision improves auditor independence
Swanger and Chewing (2001) USA	Financial analysts Phase 1 (n= 999) Phase 2 (n= 990)	17.5% 11.8%	Survey - Mail questionnaire	Outsourcing internal audit function	Negative effect if full outsourcing to the same audit personnel. Less effect if only partial outsourcing Less effect if there is separation of staff.

Author and Country	Participants	Response rate	Research Method	Factors Investigated	Major findings
Lennox (1999), UK	897 companies		Archival data	Voluntary disclosure of NAS fees	NAS improve auditor independence when NAS fee is disclosed
DeFond; Raghunandan, and Subramanyam (2002), USA	1158 distressed firms		Archival data	NAS provision and going concern opinion	No association between going concern opinions and either total fees or audit fees. No effect on auditor independence
Craswell, Stokes and Laughton (2002), Australia	1062 for year 1994 1045 for year 1996		Archival data	Fee dependence and types of audit reports	No effect
Frankel, Johnson and Nelson (2002), USA	3074 companies		Archival data	Share price reaction to higher than expected NAS fee	Negative relationship means negative effect on auditor independence
Ashbaugh, LaFond and Mayhew (2003), USA	3170 companies		Archival data	Share price reaction to higher than expected NAS fee	No relationship means no effect on auditor independence
Brandon, Crabtree, and Maher (2004), USA	333 bond issues		Archival data	NAS fee level and bond rating	Negative relationship between NAS fee level and client's bond rating
Ghosh, Kallapur and Moon (2006)	8940 firms		Archival data	NAS fees and earnings response coefficient	No association
Joshi, Bremser, Hemalatha and Al-Mudhaki (2007), Bahrain	Big 4 auditors (n= 8) Non-big 4 auditors (n= 9) Executives (n= 36)	66.7%	Survey – Mail questionnaire	NAS in general and a list of NAS	Negative effect on auditor independence NAS provision should not be banned

Appendix IV: Saudi Companies and their External Auditors

The external auditors of companies listed in the Saudi Stock Market in 2006 based on the annual report of each company – source: Tadawul www.tadawul.com.sa

Company		Auditor 1	Auditor 2
1	Riyad Bank	PricewaterhouseCoopers.	Deloitte & Touche
2	Aljazira Bank	PricewaterhouseCoopers.	Ernst & Young
3	The saudi investment bank	PricewaterhouseCoopers.	Ernst & Young
4	Saudi Hollandi bank	PricewaterhouseCoopers.	KPMG
5	Saudi Fransi bank	KPMG	Ernst & Young
6	Saudi British bank	KPMG	Ernst & Young
7	Arab national bank	Deloitte & Touche	Ernst & Young
8	SAMBA Financial group	Ernst & Young	PricewaterhouseCoopers.
9	Al rajhi Bank	PricewaterhouseCoopers.	Ernst & Young
10	Al Bilad bank	KPMG	PricewaterhouseCoopers.
11	Sabic	Deloitte & Touche	
12	Safco	Dr. M. Al Amri & Co.	
13	Saudi Arabia Refineries Co.	Deloitte & Touche	
14	Ceramic	KPMG	
15	Safola Group	KPMG	
16	National Industrialization Co.	Deloitte &Touche.	
17	Pharmaceutical	Ernst & Young	
18	Gas and Industrialisation	Saudi Accountants	
19	National Gypsum Company	Al Swailem & Al Onaizan	
20	Food Products Co.	Saudi Accountants	
21	Cable Company	Ernst & Young	
22	Saudi Advanced Industries Co.	Associated Accountants	
23	Saudi Saudi Industrial Development Co.	Al Dar CPA	
24	Al-Ahsa Development Co.	KPMG	

Company		Auditor 1	Auditor 2
25	The National Co. for Glass Industries	Deloitte & Touche	
26	Saudi Arabian Amiantit Co.	PricewaterhouseCoopers.	Alamari
27	Alujain Corporation	Ernst & Young	
28	Filling & Packing Materials Manufacturing	Al-Kharashi Certified Accountants	
29	Saudi Industrial Service	Deloitte & Touche	
30	Arabian Pipes Company	Al Bassam CPA	
31	Nama Chemicals Co.	Deloitte & Touche	
32	National Metal Manufacturing and Casting Co.	Deloitte & Touche	
33	Saudi Chemical Company	D. Al-Amri CPA	
34	Zamil Industrial Investment Co.	Ernst & Young	Deloitte & Touche
35	Saudi Industrial Investment Group	Al-Azm, Al-Sudairi & Al-Nemr CPA	
36	Sahara Petrochemical Co.	Deloitte & Touche	
37	Saudi Dairy & Foodstuff Co.	Ernst & Young	Deloitte & Touche
38	Almarai Company	Al-Dar CPA	
39	Arabian Cement Co.	KPMG	Cendi & Batarji CPA
40	Yamamah Saudi Cement Co.	El Sayed El Ayouty CPA	
41	Saudi Cement Co.	Deloitte & Touche	
42	Qassim Cement Co.	Deloitte & Touche	Boodai CPA
43	Southern Cement Co.	Deloitte & Touche	Boodai CPA
44	Yanbu Cement Co.	Ernst & Young	
45	Eastern Cement Co.	KPMG	
46	Tabuk Cement Co.	Al Swailem & Al Onaizan	
47	Saudi Hotels & Resort Areas Co.	Al-Saleh CPA	
48	Saudi Real Estate Co.	Saudi Accountants CPA	
49	The National Shipping Co. of Saudi Arabia	KPMG	Deloitte & Touche
50	Saudi Public Transport Co.	Saudi Accountants CPA	
51	Saudi Automotive Services Co.	Al-Kharashi CPA	
52	Anaam International Holding Group Co.	Azzam Sharef CPA	Ahmad Ba Jenaid CPA
53	Tihama Advertising & Public Relations Co.	Deloitte & Touche	

Company		Auditor 1	Auditor 2
54	Aseer Trading, Tourism & Manufacturing Co.	Dr. M. Al Amri CPA	Ernst & Young
55	Taiba Holding Co.	Dr. M. Al Amri CPA.	
56	Makkah Construction & Development Co.	Fouad Mokhtar CPA	Ernst & Young
57	Saudi Transport and Investment Co.	Al-Kharashi CPA	
58	Al-Baha Investment & Development Co.	Faisal Al-Sabban CPA	
59	Saudi Industrial Export Co.	Al-Kharashi CPA	
60	Arriyadh Development Co.	Ernst & Young	
61	National Agriculture Marketing Co.	Al-Kharashi CPA	
62	Tourism Enterprise Co.	Osama El Khereiji CPA	
63	Fitaihi Holding Group	Talal Abu-Ghazaleh CPA	Al-Thiniyan CPA
64	Jarir Marketing Co.	PricewaterhouseCoopers	
65	Aldrees Petroleum & Transport Services Co.	Deloitte & Touche	
66	Saudi Electricity Co.	Dr. M. Al Amri CPA	Ahmad Ba Jnaid CPA
67	Saudi Telecom	PricewaterhouseCoopers.	Deloitte & Touche
68	Etihad Etisalat Co.	KPMG	
69	The Company for Cooperative Insurance	Ernst & Young	PricewaterhouseCoopers.
70	Nadec	KPMG	
71	Qassim Agriculture Co.	Saudi Accounting Bureau	
72	Hail Agriculture Development Co.	Deloitte & Touche	
73	Tabuk Agriculture Development Co.	Osama A. El khereiji CPA	
74	Saudi Fisheries Co.	Ernst & Young	
75	Ashargiyah Agriculture Development Co.	RSM Al Bassam CPA	
76	Al-Jouf Agriculture Development Co.	Dr. M. Al Amri & Co.	
77	Bishah Agriculture Development Co.	Abdullah Shaher CPA	
78	Jazan Development Co.	Dr. M. Al Amri & Co.	