

**PROVISION OF NON-AUDIT SERVICES AND THEIR EFFECT ON AUDITORS'
INDEPENDENCE AND THE QUALITY OF AUDIT**

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Abstract

A survey was made to study the different services provided by auditors in the audit market in Sudan and study their perception the effect of provision of non-audit services on auditors' independence and the quality of audit. A questionnaire was disseminated to thirty audit firms. Analysis showed that only two types of services are provided regularly by auditors. Results have also shown that according to auditors' perceptions independence is not impaired by non-audit services however there are some areas that are controversial and need to be addressed. Equally important, evidence significantly showed that non-audit services do not adversely audit quality. Recommendations were made for policy and practice, of which: Governing bodies have to address the problems underlying auditors' independence and quality of financial reporting. Policy makers must have a rule that govern the provision of no-audit services and must establish a task force that address oversight issues when non-audit services are provides besides audit. In addition to that auditors must identify all threats to independence and must apply the necessary safeguards, and employ practices like peer reviews and mandatory rotations.

Keywords: audit services, non-audit services, auditors' independence, audit quality

INTRODUCTION

An audit is an independent examination of financial statement and expressing an opinion on them. Auditor's independence is basically defined as freedom from the factors that compromise or reasonably compromise the ability of auditors to make unbiased audit decisions. In addition to ordinary audit, auditors provide non audit services. These services generate lucrative incomes to auditors and this might impair their independence and negatively affect the quality of audit. Due to this expansion of such services and the financial scandals in the previous decade, statutory and professional rules are made.

Background Information on the Audit Profession and Standards in Sudan

The audit profession in Sudan is very small. The number of certified accountants is seventy six auditors who are either members of the Association of Certified Chartered Accountants or the American Institute of Certified Public Accountants. Of this number four are deceased, nineteen are working outside Sudan, two are practicing audit but outside the area of Khartoum and three are working for different organizations in Sudan and the rest are practicing audit.

Auditors in Sudan adopt British, American and international standards. There is not a single set of standards that is followed by all auditors. There are some local rules that are set by the Accounting and Auditing Profession Organizing Council, but they are a hybrid of British and international standards. These rules provide guidance on ethical issues and ensure that audits are conducted in accordance with the international standards and relevant national standards. Moreover there is not an overlooking body that enforces the standard and the issue of provision of non audit services has not been put under focus. Joint provision is not prohibited by the standards and the decision whether to provide joint services is left to the auditor consent.

Rationale of the Study

This study is considered important because it highlights the different services provided by audit firms in Sudan. It is the first study on auditors' perception regarding the effect of provision of non-audit services on auditors' independence and the quality of audit. The risk of providing non audit services arises from their adverse effect on auditors' independence and the quality of audit. If auditors are not independent it will be unlikely that will provide standard audit and consequently the interests of the different users of financial statements are threatened.

STUDY OBJECTIVES

1. To explore the different services provided by auditors.
2. To check auditors' perceptions regarding the adverse effect of non audit services on auditors independence
3. To check auditors' perception regarding the adverse effect of non audit services on the quality of audit.

LITERATURE REVIEW

Extensive literature has been written on audit, auditors' independence and provision of services. Audit is defined as an independent examination and expression of an opinion on the financial statements of an enterprise. Woolfe (1997) has defined audit as a process carried out by suitably qualified auditors whereby accounts are business are subject to scrutiny in such details as will enable the auditor to form an opinion.

Definition of Independence has varied; some has defined it as freedom of bias and a mental state of objectivity. Others have defined independence as avoidance of facts and circumstances that might affect their professional judgment. Woolfe (1997) has affirmed that there are identified threats to independence. These include external pressures or influence, overdue fees, loans to or from a client, receipts of hospitality or goods and provision of non-audit services.

Woolfe (1997) has highlighted the importance of quality control in auditing as it improves audit service, enhances efficiency and profitability and minimizes the auditors' liability risk. Arrunada (1999) has defined audit as the ability of an auditor to thoroughly examine accounts and detect errors and the willingness to provide an opinion on them. The SEC has prohibited of a number of services as they impair independence. These services include bookkeeping, financial information systems design and implementation, appraisal or valuation services, fairness opinions, or contribution-in-kind reports, actuarial services, internal audit, management functions or human resources, broker-dealer, investment adviser, or investment banking services, legal services and expert services unrelated to the audit. Sarbanes-Oxley Act required that auditors are prohibited from engaging in financial and business relationship, and provision of joint services (audit and non audit). Moreover auditors have to undergo rotation of partners, get approval of engagement by audit committee, report to audit committees on matters concerning the critical accounting policies, disclose the services provided audit or non audit and their fees in the past two years.

Previous studies

Previous studies on audit services focused on the effect of provision of non audit services in two ways; as an indicator of quality and as a threat to independence. Some studies have examined the perceptions of financial statement users on auditors' independence. This include Carcello et al (1992) have studied the audit quality attributes as perceived by auditors, financial statement preparers and users. It has been found that users and preparers are concerned with complying with the general audit standards while auditors perceive such services enhancing quality.

Chang and Monroe (1993) have studied the effect of reputation, length of auditor –client relationship, provision of non audit services and the level of fee dependence on auditors' perceptions of quality and independence. They found that auditors independence is impaired only if they are economically dependent on the client. Their findings also have included that auditors by providing non audit services will be familiar with the clients' business environment and hence they will be more likely to discover material misstatements.

Barkess and Simnet (1994) have used publically available information to test the relationship between the provision of non audit services and audit opinion. They have stated

that the increased provision of non audit services by audit firms may encourage auditors to become more reluctant to qualify audit reports because they do not want to lose their clients. Wines (1994) has investigated whether auditors independence seem to be impaired when higher levels of non audit services are provided to audit clients. It has been found that auditors are less likely to qualify reports when higher levels of non-audit services are provided.

Lennox (1999) has investigated the effect of non audit services on audit quality. This has been done by seeing annual reports of all UK companies between the years (1988-1994). He checked whether companies disclose their non audit services fees. It has been found that the majority of companies did not disclose non audit fees until it has become a requirement.

Attributes of Audit Quality

A study by Schroeder et al (1986) has identified several attributes of audit quality. These attributes are ranked by audit committee chairpersons and audit partners. The attributes include; audit team rotation, experience and skill of audit team, communication between audit team and management, planning and conduct of audit team work, following quality control procedures, relative significance of audit fees, recentness of peer reviews, independence exhibited by audit team and audit firm reputation.

Another study by Carcello et al (1992) had addressed the issue of quality attributes. They studied the perceptions of audit quality attributes on partners, controllers and users of financial statements. Their findings showed that audit quality attributes include; auditors in engagements must be certified public accountants, competitiveness, skill and knowledge of auditors and personnel in audit teams, audit firm reputation, communication of audit team and management, immaterial audit fees to total audit fees and participating in peer reviews process.

Safeguards to independence

Independence is a prerequisite for fairness of financial statement. As the issue of independence is sensitive, safeguards are made to limit professional activities that might jeopardize independence. Pendergast (2001) has stated that safeguards to auditors independence include professional training, professional standards, external reviews of quality control systems and policies and procedures that assure independence.

Caswell and Allen (2001) have suggested safeguards to independence. Their suggested safeguards include; raising the awareness of professional staff on the importance of independence, peer reviews, implementing quality control standards, internal monitoring and rotation of auditors.

The US General Accounting Office (GAO) (2002) has issued an independence standard that suggested employing certain safeguards on matters such as provision of non

audit services. It has recommended that audit firms must preclude personnel who provide non audit services from planning, conducting, or reviewing audit work related to audit services.

Sarbans-Oxley Act (SOX Act)

The SOX Act establishes rules and procedures for financial reporting. It was made in response to the collapse of some big companies in the United States (Enron Company). It has required that auditors refrain from being a member of the management of the audit client, partners rotation, make specific disclosure regarding the provision of audit and non audit services, registration of auditors, quality control, inspections, and policy enforcement, transparency in financial reports and disclosures, criminal penalties for destruction or alteration of financial transaction records.

The SEC has prohibited a number of services including bookkeeping services, financial system design and implementation, appraisal and valuation, advisory services, internal control services, management functions, human resources function, broker-dealer services and legal and expert services.

Consequences of Provision of non audit services

Mitchell et al has stated that the provision of non audit services may impair independence or the appearance of independence. Parakash and Venable (1993) has affirmed that the provision of non audit strengthen the economic bond between auditors and their clients. Arrunada (1999) has stated that provision of non audit services provide cost savings, enhance technical competence and do not jeopardize independence. Arrunada (1999) went even farther and stated that such services may increase auditors' cautiousness when performing audit as they do not want to destroy their reputation.

Quality Control in Auditing

The International Standard in Auditing 220 has identified six objectives of quality control in auditing assures; personnel adherence to the ethical conduct, staffing competent staff, audit work assigned to competent auditors, proper planning for audit, continuous evaluation of clients and implementing inspection programs.

Attributes for Audit Quality

Shockley (1981) has found that long term relationship between auditors and client reduces the auditors' ability to detect errors in financial statement as they employ less rigorous audit procedures.

Carcello et al (1992) has identified various attributes of audit quality. These include; high knowledge and ethics of audit team, good knowledge of the client environment, strictness on completing audit steps, audit fee immaterial to audit firm and consulting service is provided.

Literature has described a lot of issues concerning non audit services, independence and independence. Literature addressed the issue of joint provision of audit and non audit services as a controversial issue as they are considered threats to independence and audit quality. Accordingly a number of safeguards are established to counterbalance this adverse effect.

PROPOSED HYPOTHESES

1. The market in Sudan is a multi- service market.
2. Non audit services do not have an adverse effect on auditors' independence.
3. Non audit services do not have an adverse effect on the quality of audit.

METHODOLOGY

Data has been collected from both primary and secondary sources. Literature survey has been conducted by reviewing available literature. Secondary data include books, previous research and publications in addition to library records and online systems. Background information about auditors, their number and their address was obtained from (The Accounting and Audit Profession Organizing Council) previously the (Sudan Council of Certified Chartered Accountants).

Primary data was collected by means of questionnaires. Questionnaires have been designed in a way that insures that variables are adequately measured. As for the questions, close ended, double barred and ambiguous questions have been avoided. Thirty questionnaires were distributed to auditors in the area of Khartoum.

Questionnaires was divided into four sections. The first one is composed of general questions about job status, years of experience, educational level and membership and standards adopted. The second section is designed to study the different services provided by auditors. Auditors were given a list of services from which they choose which ones they provide. The list included; Audit, bookkeeping, financial information system design and technology, valuation services, actuarial services, internal audit services, human resources functions, broker-dealer services, expert services, tax services and management advisory services. The third section studies auditor perceptions on the effect of provision of non audit services on auditors' independence. Questions asked whether non audit services affect the following; abiding with independence principals, attaining the appearance of being independent, dependency of auditors on few clients, auditors decision about qualifying reports, devising acceptable treatments in order to satisfy their clients, auditors' rotation, creation and reporting to

audit committees, second partner review, reducing the cost of audit firms and willingness to disclose non audit services fees. The fourth section included question about auditor's perception of the effect of provision of non audit services on the quality of audits. The question asked whether non audit services adversely affect the following; the effort for keeping the firm up to date technically, search for new clients, meeting professional responsibilities, the staffing of competent staff, reviewing audit work and reducing communication between audit team and management, timely communication of policies and procedures to the audit staff , monitoring the compliance (one yearly) with the professional regulations, compliance with the quality control procedures ,maintain a level of competence in audit, concern about their reputation and ,overlook opinion format, monitoring the effectiveness of quality control and the recentness of the peer reviews become more familiar with their clients environment.

ANALYSIS AND FINDINGS

A survey was made on the services that auditors provide auditors' perception on audit quality and auditors independence. The sample is composed of thirty auditors working in the city of Khartoum. Data has been collected, edited, coded and categorized before they are ready for analysis using Statistical Packages for Social Sciences. The findings are portrayed in three sections; the first describes the frequencies, the second describes the correlation analysis, while the third step-wise regression. Frequencies analysis described the bio-data, the nature of services provided by auditors, perceptions of auditors towards independence and finally the perceptions of auditors towards audit quality.

General Information about Auditors

The sample under study is composed of (30) auditors working in the city of Khartoum. Bio-data showed that majority of respondents are certified accountants who are members of recognized accountancy bodies either the Association of Certified Chartered Accountants or the American Institute of Certified Public Accountants. They have at least fifteen years of experience and use international /local standards. The long years of experience and the use of international standards indicate that the sample members are professionally trained and auditors must necessarily comply with the international standards of audit which are harmonized for the use of all countries.

Market for audit and non audit services in Sudan

The results have shown that all of the thirty auditors provide audit services, (80%) provide tax services and almost (50 %) provide financial information systems design and implementation.

Almost half of the sample provides management advisory services, almost (40%) provide expert services and approximately (30%) of the sample provides bookkeeping services.

As for Valuation services the results showed that almost (30%) of the sample provide these services, (20%) of the sample provide internal audit services, (10%) provide legal services, (10%) provide human resources, none of the sample members provide actuarial services or broker-dealer services. One major feature of the findings is that auditors mainly provide audit and tax services while the other services are not frequently provided. Correlation analysis has shown that audit market is a multi-service but auditors when they normally provide audit services they do not provide non-audit services. That is, there is no joint provision of audit and non-audit services. Regression analysis also has shown that the market can be describes as a multi-service market.

Compliance with independence standards

The second hypothesis stated that non-audit services do not adversely affect auditors' independence. Results from frequencies have shown that the majority of the sample agrees that auditor abide with independence principals, attain the appearance of being independent and that non audit services are unlikely to jeopardize independence. This result agrees with the IFAC which requires that must abide with independence and attain the appearance of independence. The majority of auditors believe that provision of non audit services have no effect on the dependency of auditors on few clients. This is unlike Goldman and Barlev(1974) who have stated that auditors' independence may be threatened by provision of non audit services because non audit services fees increase auditors dependence on their clients.

Moreover nearly (50%) of the sample agrees that these services affect auditors decision about qualifying reports and device acceptable treatments in order to satisfy their clients. This result agrees with Simunic (1984). On the other hand the majority agrees that auditors' rotation, creation and reporting to audit committees are not affected by the provision of non audit services. This finding agrees with Meuwissen et al (2002) who stated that the creation of audit committees neither affected by the provision of non audit services nor reporting to it. The majority of auditors also agree that audit fees are affected by the provision of services. This agrees with Wines (1994) who has found that auditors are less likely to qualify reports when higher level of non audit fees is derived. The majority also agree that auditors are willing to disclose non audit services fees and consider these services having no effect on the second partner review.

Furthermore the majority of the sample believes that non audit services reduce the costs of the audit firms, this disagree with Abdel Khalik.(1990) whose results have shown no costs or benefits from the provision of non audit services. In discussing the results obtained, according to

auditors' perception non audit services may pose a threat on auditors' independence as some auditors may not comply totally with the standards but the majority perceives non audit services as not jeopardizing auditors' independence.

Correlation analysis has shown that some perceptions of auditors that indicate compliance with the standards are weakly correlated with non audit services. On the other hand, other results have indicated that some perceptions are strongly correlated with non audit services. According to correlation analysis the issue of adverse effect of non audit services on auditors' independence is controversial.

Further testing has been made using regression analysis. Results have shown that almost all auditors have agreed upon certain perceptions concerning independence requirements and disagreed on others. The reason behind this disparity might be the lack of knowledge of some of the respondents about some recent requirements in the audit standards.

Audit Quality

The third hypothesis stipulates that non audit services do not adversely affect the audit quality. Frequencies showed that (100%) of the sample members agree that non audit services neither affect the effort for keeping the firm up to date technically, nor the search for new clients. All the sample members agree that non audit services do not affect; meeting professional responsibilities, the staffing of competent staff, reviewing audit work and reducing communication between audit team and management. This agrees with the International Standard in Auditing 220 .

The majority of the sample has agreed that non audit services do not affect the timely communication of policies and procedures to the audit staff or monitoring the compliance (one yearly) with the professional regulations. This agrees with Schroeder et al (1986) who have identified this perception among the attributes of audit quality. The majority believe that non audit services enhance the quality of audit as auditors become more familiar with their clients environment. This agrees Pitt and Birenbaum (1997) who have stated that non audit services enhance auditors' information about their clients business which is useful when performing the audit. In addition to that auditors believe that non audit services neither affect compliance with the quality control procedures nor do not affect maintain a level of competence in audit.

The majority of auditors also believe that non audit services increase auditors concern about their reputation and that they will neither overlook opinion format nor monitoring the effectiveness of quality control. Finally the majority of the sample has agreed that non audit fees have no effect on audit fees and that they have no effect on the recentness of the peer reviews. This agrees with Carcello et al (1992) who have identified this perception in their study.

Correlation analysis results obtained have found auditors' perception positively correlated with each other and with non audit services. This proves that non audit services have no adverse effect on audit quality. In view of that, auditors are considered abiding with audit quality standards and attributes when they are providing non audit services. The results obtained from regression analysis support the hypothesis that non audit services do not adversely affect audit quality. The results showed significant value for regression. It is evident from the result that auditors comply with the audit standards and attributes.

Summary of Findings

The overall results obtained from the study suggested three important facts. First, auditors in the Sudan provide audit and non audit services and hence the market in Sudan is a multi-service market. Second, in audit profession non audit services are perceived not adversely affecting auditors independence. Nonetheless according to some auditors according to some auditors non audit services may pose some threat on auditors' independence and may jeopardize it. Third, regardless of these facts, auditors do not provide substandard audit and abide with the audit quality standard and attributes.

RECOMMENDATIONS

Recommendations that are made, are twofold: for governing bodies and for auditors.

Recommendations for governing bodies

1. Governing bodies must require that auditors enact the Code of Ethics and quality control standards.
2. Policy makers must have a rule that govern the provision of non audit services.
3. Policy makers must establish a task force to address issues when non audit services are provides besides audit.
4. Policy makers must require continuous educational for all auditors to keep them up to date.
5. Policy maker must require disclosing audit and non audit fees.

Recommendations for auditors practicing audit

1. Auditors may provide non audit services as they increase auditors effectiveness, but must avoid joint provision of audit and non audit services.
2. Auditors may increase the auditors' independence by enforcing the establishment of audit committee which regulated the provision of non audit services.
3. Auditors must adopt mandatory rotation of audit firms and audit staff.
4. Auditor must realize the importance of peer reviews and must employ that.1

CONCLUSION

In the past few years researcher have become interested in the effect of provision of non audit services on auditors independence and the quality of audit. This study investigated the different types of services provided in the audit market in Sudan as well as the perceptions of auditors on the provision of non audit services and their effect on auditors' independence and the quality of audit.

The study hypothesized that the market is multi-service and that provision of non audit service neither adversely affect the quality of audit nor auditors independence. Perceptions of auditors were measured using a 5-point scale. This scale has been used to capture the large variation in the perceptions of auditors. The results have shown that audit firms provide tax services regularly besides audit. As for other non audit services they are not provided frequently. The results have suggested that auditors generally do not perceive non audit services as impairing independence, although some perceptions may reflect that such services may jeopardize independence. The third result has suggested that non audit services do not adversely affect audit quality. According to these results the argument against non audit services as far as the market in Sudan does not hold.

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