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AUDITOR'S INDEPENDENCE IN DIFFERENT COUNTRIES

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Abstract: Independence is the keystone of the audit profession; without independence, the users of financial statements would not be able to rely on the auditor's report. Auditor independence in developing countries is important since the auditor by providing credibility to financial statements facilitates the allocation of scarce capital resources in financial and capital markets. The concept of independence is not absolute; no auditors can claim complete independence of a client. Rather, independence is relative - a matter of degree. In this paper we will try to give a summarized picture of Auditor's Independence in different countries.

Key words: Auditor; Independence; Financial statement; True and fair view; Compliance

Introduction

As the concept of independence is at the center of the audit function, the accounting profession has long recognized the need for auditor's independence in both fact and appearance. To optimize the image of independence in practice, an auditor must remain free of any obligation or interest that would damage independence in appearance. Auditor's independence is necessary for formulating international harmonization of auditing standards. Without independence, the value of any auditor's work to the client or to the investing public is questionable. The objective of this paper is to determine the degree of the independence of the auditors in terms of different countries different act and regulations.

Founded in 1977, the International Federation of Accountants (IFAC) is a federation of national professional accounting bodies. Its objective is the development and enhancement of a co-ordinated world-wide accountancy and auditing profession and the harmonization of accounting principles and auditing standards. In 1977, IFAC issued the International Audit Guidelines (IAG). One of the guidelines defines independence as the ability of the accountants to be and appear to be free of any interest that might be regarded as being incompatible with integrity and objectivity. The European Union (EU) Fourth Directive requires companies, whose annual accounts are required to be audited, to appoint an auditor to examine the accounts and express an opinion about whether they present a "true and fair" view (AICPA, 1987). The Eighth Directive, adopted in 1989

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and implemented on January 1, 1990, deals with the qualifications of statutory auditors, reciprocity, and independence. Independence is one of the areas of strong disagreement in the draft of the Directive. Some countries felt that statutory auditors should do nothing but audit financial statements, whereas other countries felt that tax and advisory services could be performed by auditing firms without impairing independence. Since no agreement was reached on independence, the Eighth Directive decided to allow the individual member countries to determine the condition for independence.

Methodology

This paper is totally based on the information of the secondary source. In some cases we download some article from the Internet. Secondary sources were journals, Reports, books and other research publications related to auditor's independence.

Auditor's Independence in Different Countries:

A. Asian countries

(i) **The Japanese perspective:** *The* history of some business failures in Japan illustrates the lack of fit of the Anglo-American focus on independence within the Japanese collective culture (McKinnon, 1984). CPAs and audit corporations are required to be independent of their clients under both the CPA law and the securities and exchange law. CPAs or audit corporations may not render continuous tax services for a fee to audit clients. Tax return preparation services are instead provided by certified tax advisers (CTAs). The by-laws of the Japanese Institute of Certified Public Accountants (JICPA) include rules of professional ethics and independence. Audit standards are provided under the Auditing Standards, Audit Procedures Rules and Audit Reporting Rules issued by the Enterprise Accounting Deliberation Council of the Ministry of Finance (Price Waterhouse, 1993). The Japanese business law requires the presence of a statutory auditor to look after stockholder interests, the relationship between the statutory auditor and the corporation is typically of independence between management and auditor. In reality the financial and mental independence necessary for the objective performance of the statutory auditor's review and supervisory duties remain absent (Albrecht, et al., 1988). Owing to the collective nature of Japanese culture, auditors have little success in obtaining the specific documents necessary to independently assess the financial position of the entity audited. Internal auditors within the Japanese firms appear much less independent. They report to high-level management and do not have an audience with the board of directors (Price Waterhouse, 1993c).

(ii) **The Singapore perspective:** In Singapore all registered companies under the Companies Act should audit their statements by an Auditor. The Singapore Auditing Guideline (SAG) # 4, Basic Principles Governing an Audit, requires auditors to be independent, honest, and sincere. They must not allow prejudice or bias to override their objectivity. Independence is impaired when (a) the auditor was an officer or employee of the company audited; (b) the auditor has direct or indirect interest in the company audited; and (c) members of the auditor's immediate family hold a significant beneficial interest in the company audited (Price Waterhouse, 1994).

(iii) **The Hong Kong perspective:** In Hong Kong, companies are incorporated under the Companies Ordinance and are required to appoint an auditor to audit their financial statements. The Hong Kong Society of Accountants has set forth guidance on

professional ethics and independence that are similar to those of the USA. The code of ethics warns auditors to exercise due care, objectivity, and integrity. They must avoid situations that may impair their independence. Managing directors share a consensus perception of the audit function as an independent appraisal of the company's internal control system. More than 50% of top management believe that independence of the internal auditors is enhanced when they report to an audit committee (Jensen, 1995).

(iv) The Chinese perspective: In China, CPA profession is regulated by Ministry of Finance. The Chinese Institute of Certified Public Accountants (CICPA), which was established in late 1988, is the organization that actually regulates the profession. China does not have a private professional standard board to set national audit regulations. Regulations are set by the government and contained in the Audit Regulations of the People's Republic of China 1989. The new audit regulations aim at improving and strengthening the independence of auditors. Audits are required under the income tax laws and audited financial statements are therefore prepared for tax reporting purposes. The audit requirements for foreign investment enterprises are contained in the Accounting Regulations of the People's Republic of China for Enterprises with Foreign Investments promulgated in July 1992 (Price Waterhouse, 1992c).

(v) The Malaysian perspective: Since one's usefulness as an auditor is impaired by any feeling on the part of third parties that he is likely to lack independence, he has the responsibility of not only maintaining independence in fact but also of avoiding any appearance of lacking independence. In Malaysia, the accounts of all companies incorporated under the Companies Act 1965 must be audited by an independent auditor. In order to qualify as auditor, a person must be approved by the Ministry of Finance. The Companies Act requires auditors to report to the Registrar of Companies any breach or nonobservance of any of the provisions of the Companies Act (Price Waterhouse, 1994b).

B. European countries:

(i) The UK perspective: For over 100 years, the accountancy profession in the UK has built its reputation on the foundation of objectivity, integrity, and competence which include all that is required for auditor independence. The British have emphasized auditor's independence for almost two centuries. The provision against auditors serving as officers or employees of their auditees has been a landmark of the British system. A concern for the auditor's independence in the UK appeared in the Companies Clauses Act 1845, section 102, which prohibited auditors from serving as officers of the company.

The standards of independence in the UK are similar to those in the USA, although one major difference is that, in the UK, independent auditors are allowed to perform certain bookkeeping functions for private companies. The Companies Act 1985 requires companies to issue audited financial statements. Auditors have the right of access to books, records, and other pertinent information as needed to carry out their statutory duties. The first statement on ethical matters requires a member in public practice "to be and to be seen to be independent" (AICPA, 1987). The UK amended the Companies Act 1985 to implement the European Union's Eighth Directive. It lays down minimum approval requirements for company auditors, including their education and training. It obliges member states to ensure that company audits are performed with integrity and that there are appropriate safeguards to protect auditor's independence (Anderson and Keenan 1990).

(ii) The French perspective: In France, Accounting profession is divided into two main bodies- (a) The Ordre des Experts Comptables et des Contable Agrées includes all qualified independent accountants; and (b) The Institute of Statutory Auditors (Compagnie Nationale des Commissaires aux Comptes) is the professional body of official statutory auditors. Statutory auditors are required to be independent of their clients. Any remuneration from the client company other than that for the audit is prohibited. The auditing standards are similar to those of the USA (Price Waterhouse, 1993b). In January 1996, the Federation of European Accounting Experts released The Role, Position and Liability of the Statutory Auditor in the European Union which prohibits the simultaneous provision of all non-audit services by statutory auditors.

(iii) The Spanish perspective: The Spanish government approved a law requiring annual financial statements for all entities except small companies in 1988. A stock exchange regulation provides that companies quoted on the stock exchange must appoint independent auditors. The Instituto de Contabilidad y Auditoria de Cuentos published the auditing standards in its Gazette. The auditing standards are similar to those of the USA and include guidelines on auditor's independence, integrity, and objectivity (Price Waterhouse, 1990).

(iv) The Swedish perspective: In Sweden, the Institute of Authorized Public Accountants has developed rules of professional ethics similar to those of the US certified public accountants that include guidelines on auditor independence, confidentiality, and professional conduct. The Companies Act prohibits the engagement of an auditor who is not personally, professionally, and financially independent from the company. Both the Companies Act and the Institute of Authorized Public Accountants consider independence in fact and appearance to be a requirement for any audit engagements (Forster, and Svensson 1987).

Recently, a Swedish law has required that internal auditing of public authorities be performed in accordance with the IIA Code of Professional Ethics and the generally accepted internal auditing principles as outlined in the IIA Standards for the Professional Practice of Internal Auditing (SPPIA). This initiative proposed by the Swedish National Audit Bureau will not only enhance internal auditor independence but will also recognize internal auditing as an international profession. Previously, the Swedish internal auditing had taken three forms- (a) The internal audit department served mainly as a support unit for external auditors performing financial audit; (b) The internal audit department performed operational audit and had no responsibility for financial audits; and (c) There was no internal audit service at all (Chapman, 1995a).

(v) The Swiss perspective: In Switzerland, corporations are required to have one or more auditors who must be independent of the board of directors and shareholders. They must also be independent of companies belonging to the same group of companies. Independent auditor's report on compliance with legal requirements and provide support to business management on financial matters. The Swiss Institute of Certified Accounts and Tax Consultants issued ethical rules dealing with auditor's independence and objectivity (Price Waterhouse, 1992a).

(vi) The Danish perspective: All limited liability companies are required to be audited in Denmark by certified auditors licensed by the Ministry of Industry. To the Danes, the

following constitutes impairment to independence- (a) Auditors are not allowed to receive loans or guarantees from a company that they audit; and (b) CPAs are not allowed to render an opinion on the financial statements of a company that has any kind of economic influence in the form in which the auditor is an employer. The following persons are precluded from acting as auditors- (a) members of the board of directors of a company; (b) persons who are employed by the company; and (c) persons who are related by marriage, adoption, or family relation to the directors or management of the company. However, rendering consulting service does not prohibit an individual from acting as an independent auditor (Ernst and Young, 1994).

(vii) **The Dutch perspective:** The financial statements of Dutch companies are audited to meet statutory and stock exchange requirements. In 1984, the Dutch adopted the EU Fourth Directive which requires that the annual accounts be audited. The Dutch audit philosophy and practice is similar to the US practice. The Code of Ethics has a legislative status and gives guidance to its members on matters dealing with auditor independence, due care, and professional conduct. The requirement of objectivity and independence is detailed in Article 20 of the Code. Auditors engaged in practice may not perform a service for a person, corporation, or institution if they have a vested interest that may affect their objectivity (Ernst and Whirney, 1987).

C. The Australian and New Zealand's perspective

i) **The Australian perspective:** According to Australian corporate law, the auditor of a company is required to report to the shareholders on every balance sheet and profit and loss account (income statement) submitted to shareholders of the company. The auditor has the right to access at all times the accounting and other records of the company and the right to obtain from officers of the company such information and explanations as are required for the audit. Australian auditing standards (AUS) are comparable with those applicable in the USA. In Australia it requires that auditors be independent, honest, and sincere. They shall maintain an impartial attitude and be free of any interest that might be regarded as being incompatible with their integrity and objectivity. Auditors are prohibited from:

- Being beneficiary owners of shares in an audit client;
- acting as trustees of a trust or as directors of a corporate trustee company;
- accepting, making, or guaranteeing loans from or to an audit client;
- accepting from audit clients goods or services on terms more favorable than those generally available to others;
- accepting or retaining a directorship of a company that exerts significant influence over another company that is an audit client;
- acting in an executive decision-making role when providing management consulting services to an audit client;
- participating in the preparation of the books of account of a public company being audited (Forster, 1994).

ii) **The New Zealand perspective:** Companies incorporated under the New Zealand Companies Act 1955 are required to have their financial statements audited. All foreign-owned subsidiary companies must also be audited by a New Zealand chartered accountant. The Code of Ethics of the New Zealand Society of Accountants is similar in many respects to those of the USA, Australia, Canada, and the UK (Price Waterhouse, 1993a). The Office

of the Auditor General's Guidelines on Integrity, Objectivity, and Independence preclude statutory auditors who certify financial statements of a company from serving as internal auditors of the company.

D. South American perspective

The Argentine perspective: In Argentina, annual financial statements of all companies must be audited by an independent public accountant. The auditor's report, issued after an examination made in accordance with defined auditing standards, must be filed with regulatory authorities. Auditing standards are similar to those of the USA and are embodied in Technical Pronouncement No. 7 of the Argentine Federation of Professional Councils of Economic Sciences. Auditing standards include guidelines dealing with auditor's independence, integrity, and objectivity (Price Waterhouse, 1992b).

E. North American perspective

The Canadian perspective: In Canada, an auditor must be independent, must be licensed by the province in which he practices, and must comply with the rules of ethics of the organization to which he belongs. The auditor has a statute-protected right of access to all books, records, information, and explanations that he requests. The Canadian Business Corporation Act requires an auditor to be independent. However, the Act permits an interested person to apply to the court for an order exempting the auditor from the requirement to be independent. The Act still requires the audit to be conducted with generally accepted auditing standards and the financial statements to be prepared in accordance with generally accepted accounting principles (Price Waterhouse, 1994a).

F. African countries

The Africa perspective: Auditing has always been seen as an alien phenomenon in most parts of the Third World, especially in Africa. This is because of Africa's history, culture, and collective way of life . The Charter, as defined by the Institute of Internal Auditors, does not really seem to give that unrestricted scope to Third World auditors. If auditing is a reflection of culture, applying the IIA standards of independence and objectivity poses a serious dilemma to Third World auditors.

G. The Middle East

The Israeli perspective: The Israeli legislature, the Knesset, passed the Internal Auditing Act 1992 on 16 March, 1992. The new law makes the State of Israel one of the few to award such explicit statutory status and governmental recognition to the internal audit function and the role of the internal auditor. It requires public institutions to establish the internal auditing function in their organization. The legislation has safeguards for auditor's independence. The Israeli Securities and Exchange Commission Act 1968 and guidelines published on 24 July, 1989, by the Israeli Institute of Certified Public Accountants preclude statutory auditors who certify financial statements of a company from serving as internal auditors.

H) The Russian Federation perspective

Auditing in the Russian Federation is in its infancy. In December 1993, the Presidential Commission on Auditing Activity started to issue licenses to auditing firms to carry out auditing activities. The Commission plans to co-ordinate auditing practices and issues guidelines dealing with auditor's objectivity, integrity and independence (Price Waterhouse, 1991).

I) Bangladesh perspective

Audit function is required for all business and industrial organization in Bangladesh and the audit process consists of examination, testing and appraisal of the organization's accounting system, and of the annual financial reports produced from that system. It is conducted by independent Chartered Accountant (Auditor) who is appointed by the owners or shareholders and who is legally required to report to them. To facilitate the work, the auditor has the legal right of access to any records, which he wishes to inspect, and is empowered to obtain explanations from the company officials on any matters, which he considers relevant to the audit. The Institute of Chartered Accountants of Bangladesh has formulated such rules and regulation for the members to win confidence of the public and their clients since they possess a great deal of information of the business of their clients and which information can be used by them to the detriment of their clients. It is the duty of the auditors that the information, which they give, about a public company is correct. If the information given is incorrect as a result of which the investing public suffers, it may not rely on the accounts certified by the auditors. The members are expected to be under certain obligations to the members of the public while performing their professional duties. The profession of Chartered accountant is governed by the following:

- 1) The Bangladesh Chartered Accountants order 1973;
- 2) The Bangladesh Chartered Accountants bye laws 1973; and,
- 3) Directives of the council and decision of the institutes.

The Institute of Chartered accountants of Bangladesh is now a statutory autonomous body and is administered by the council of twenty members. The council is assisted by the standing committees known as executive committee, investigating and disciplinary committee. The chartered accountants bye-laws also provide for the formation of regional committees to look after the interests of the members. The members are divided into classes namely Associates and fellows. The Institute of chartered Accountants of Bangladesh (ICAB) being a member of both The International Federation of Accountants (IFAC) and the International Accounting Standards Committee (IASC), it (ICAB) has undertaken to work towards implementation of the IFAC Guidelines including International Accounting Standards (IAS) and International Standards on Auditing (ISA). The Council of ICAB has a Standing Committee named Technical and Research Committee (TRC) with the responsibility to work towards adoption of IAS and BAS (Bangladesh Accounting Standards) and ISA as BSA (Bangladesh Standards on Auditing) for the application in Bangladesh.

We have emphasized auditor's independence since our independence. A concern for the auditor's independence in the Bangladesh appeared in the Companies Act 1994, which prohibited auditors from serving as officers of the company. The Companies Act 1994 requires companies to issue audited financial statements. Auditors have the right of access to books, records, and other pertinent information as needed to carry out their statutory duties. It lays down minimum approval requirements for company auditors, including their education and training. It obliges ICAB to ensure that company audits are performed with integrity and that there are appropriate safeguards to protect auditor's independence.

Conclusion

In several countries, the implementation of auditor's independence and the compliance with professional audit standards are carried out by their governments and, in many occasions, sanctioned by professional associations. Independent auditors may be censured and even expelled from their respective professional associations if they are found in violation of their codes of ethics. Cross-cultural differences may limit the effectiveness of auditor's independence even within a relatively homogeneous profession such as auditing. First, they create a lack of consensus within a profession as to what constitutes auditor's independence; and, second, they cause a diversity of interpretations. The Western concept of auditor's independence runs counter to the cultural values of the Asian communal society. Even Confucius's admonishments discourage auditor's independence, China, Japan, Malaysia, and Singapore may adopt international auditing Standards for their multinational corporations, still their cultural values are inconsistent with the independent relationships of the Asian society, their belief in the centrality of the group, and its resulting desire for privacy.

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