



JÖNKÖPING INTERNATIONAL  
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# **Non-Audit Services – Just Unjust?**

Practitioners and regulators opinion divergence on audit quality

Master's thesis within Financial Accounting

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## **Prelude**

We would like to thank our tutor "The Oracle" Karin Brunsson for her support and guidance throughout the process of making this thesis. Without her advices and wisdom we would not been able to complete this task.

We would also like to thank our respondents from the audit firms and the EU-commission for taking their time to contribute to our thesis. We really appreciate that they took their time to answer our questions, despite their busy schedule.

This journey has been both giving and worthwhile, and we have learned a great deal about matters around the thesis topics non-audit services and audit quality

**Jönköping 2013-05-17**

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## Master's Thesis in Financial Accounting

Title: Non-Audit Services – Just Unjust  
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Tutor: Karin Brunsson  
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### **Abstract**

**Background:** Over the years the EU, the US and the rest of the world have experienced several devastating financial crises. As a result of the Great Recession and several accounting scandals the EU-commission added new proposals of regulations. The Commission carried out a proposal to restrict the non-audit services to audit clients with the purpose to achieve improved audit quality and a more competitive market, which was later approved by the European Parliament.

**Purpose & Problem:** The purpose of this thesis was to evaluate how non-audit services to audit clients affect the audit quality and with that information *evaluate the opinion divergence between the regulators and the practitioners, on providing non-audit services to audit clients and its effect on audit quality.*

**Method:** Our intentions were to compare collected evidence and earlier reports with fresh intake of raw data along with statements from several interview subjects from different positions such as the EU-commission and audit firms. By gathering information from both company personnel and state-working staff in the area of auditing, we obtained sufficient information on the thesis empirical findings we did also take part of professional bodies like IFAC and FAR.

**Conclusion:** Our conclusion is that both regulators and practitioners chose to define audit quality based on their own interests. We believe that this creates an opinion divergence. In order to resolve this conflict of interest, there is a need to agree on a universal definition of audit quality. To be more particular a definition that leave no room for ambiguities and misinterpretation regarding both practitioners and regulators.

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## Abbreviations

|       |  |
|-------|--|
| EU    | European Union   |
| GDP   | Gross Domestic Product   |
| SOX   | Sarbanes-Oxley Act   |
| SME   | Small-Medium Enterprises   |
| SMP   | Small-Medium Providers   |
| PIE   | Public Interest Entities   |
| APB   | Auditing Practices Board   |
| FAR   | Association of Swedish Accountants, Consultants, Auditors and Advisors |
| IAS   | International Accounting Standards                                     |
| AICPA | American Institute of Certified Public Accountants                     |
| IESBA | The International Ethics Standards Board for Accountants               |
| JIBS  | Jönköping International Business School                                |
| IFAC  | International Federation of Accounts                                   |
| PAO   | Professional Accountancy Organizations                                 |
| IT    | Information Technology   |
| CAJEC | Chartered Accountants Joint Ethics Committee                           |
| ISQC  | International Standard on Quality Control                              |
| UK    | United Kingdom   |

## **Audit quality under questioning**

Over the years the EU, the US and the rest of the world have experienced several devastating financial crises. In the early 1930s almost the entire world was affected by the Great Depression, causing a severe impact on many companies and banks all over the world. The effect of the depression led companies and banks into bankruptcy, forced a lot of people into civil bankruptcy and the world GDP declined (Lloyd, 2011). In 1987 the global stock-market collapsed, Dow Jones<sup>1</sup> dropped 23% in one day and parallels from the great depression in the 1930s could be distinguished. The collapse is known as Black Monday (The Economist, 2012).

As a result of numerous bad investments and bad judgement of auditors led to the most recent collapse which occurred between 2007-2009, this collapse is known as the Great Recession (Lloyd, 2011). The greatest incidents that caused the recession were along with others the bankruptcy of the Lehman Brother Bank<sup>2</sup> in 2008-2010, the housing bubble in 2007 and the European Sovereign-debt<sup>3</sup> (Lloyd, 2011). The fact that numerous banks revealed huge losses from 2007-2009 on the positions they held both on and off the balance sheet, raises not only the question of how auditors could give clean audit reports to their clients for those periods (2010/561/COM final).

But this is not the first time that audit quality has been questioned. Beyond the collapses during the last years, there have also occurred several accounting frauds with Enron as one of the most prominent example. Enron was hiding billions of dollars in failed affairs by exploit loop holes and purposely kept the board of directors as well as the audit committee in the dark about the real situation (Bryce, 2002). As a result of several similar events, a wide-ranging re-examination of standards was developed in the early 2000<sup>th</sup> in the US, known as the Sarbanes Oxley Act (Cornford, 2004) and several years later the attention was drawn to the European auditors, in the form of the Green Paper.

## **The audit profession today**

Even though there have been a number of scandals over the past years, there is still a demand from the stakeholders that the entity of interest have an auditor to “cleanse” the financial statements and provide high audit quality. Sometimes stakeholders must make

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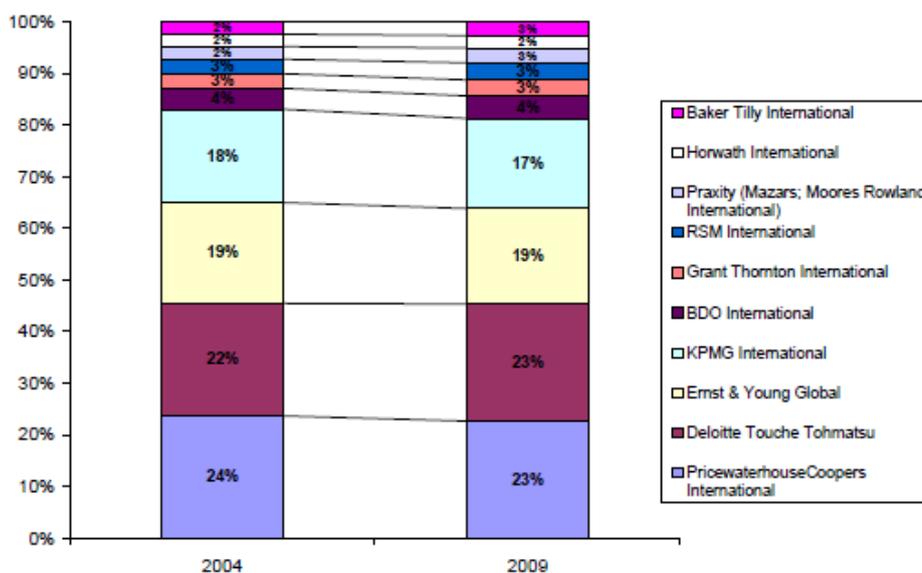
<sup>1</sup> Dow Jones - The American stock market of listed companies

<sup>2</sup> Lehman Brothers – One of the largest bank in the UK while it still existed (until around 2008-2010)

<sup>3</sup> Sovereign Debt- The debts a country owes to the .... skriv

difficult decisions based on nothing else but the financial statements of the entity and must therefore be confident with the numbers (Hayes et al., 2005; Limpberg, 1932; Carington, 2010). But the auditors have more at stake than just the appearance as a “ritual priest” when the entities call for their aid to “cleanse” their financial statements (Pentland, 1993). The most successful and influenced audit firms internationally today are the famous “Big four” that consist of KPMG, Deloitte, Ernst & Young and PWC (Carington, 2010). What can be said with certainty is that the “Big four” hold the larger share of the market in the EU-region with almost 80% of the market shares combined (see Table 1). The audit market also has a low rate of change in the shares of the market, the biggest firms remain market leaders and they only compete with each other while the SMPs do not have the same influence on the structural changes in the market (2011/1384/SEC final).

**Table I - Developments of the relative market shares**



Developments in the relative market share of largest audit firm networks in term of total world-wide revenues (2011/1384/SEC final)

### Non-Audit services

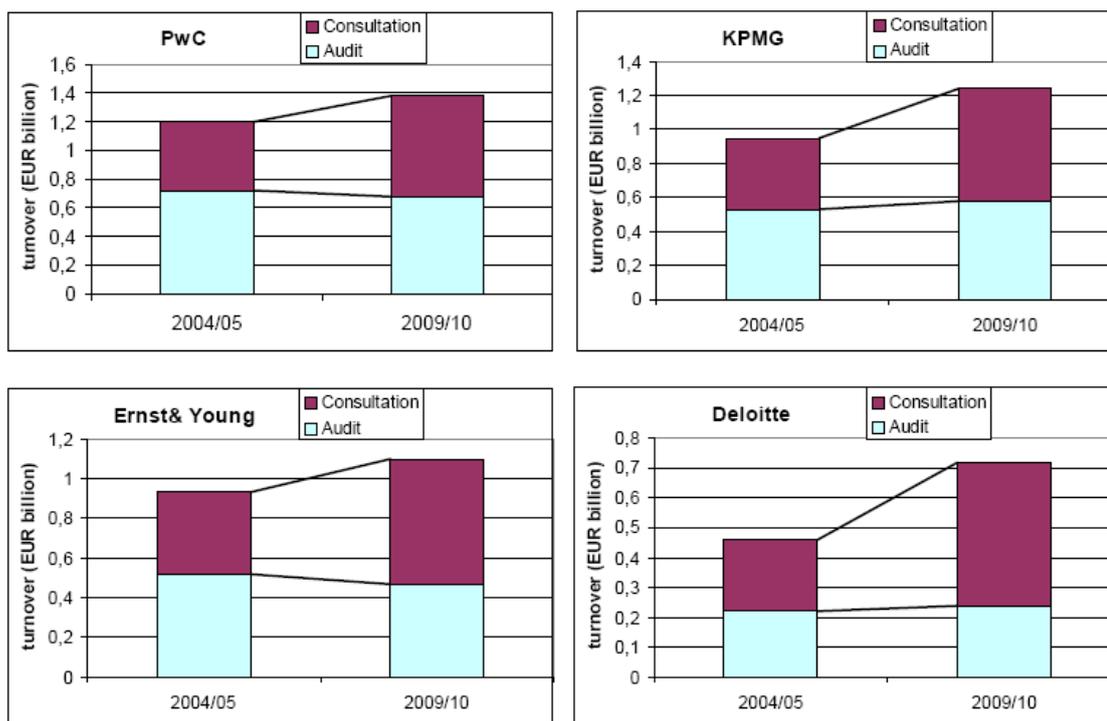
The audit firms today have a major demand to be able to provide several services besides the audit to their clients (SOU, 1999:43; Tanewski & Carey, 2007). Companies that seek an audit do not only require an audit opinion on their financial statements but also assistance with tax issues, consulting and financial advisory (Abdel-Khalik, 1990). This demand is commonly titled as non-audit services, which are all the services an audit firm offer a client besides the audit opinion (Arruñada, 1999). When an auditor does

an audit report and they find errors, they make notes to the company with matters that have to be fixed in order for the auditor to give a “green light” on the audited company’s financial statement (FAR, 2012). It is at this point that non-audit services are essential for the audit firm as well as the audited company, since the company may need help from the professionals, the audit firm, to be able to meet up with the requirements that the audit notes requires (Elliot & Pallais, 1997). The audit firms on the market are therefore offering their clients a package deal consisting of non-audit services and the final audit opinion, since the market is asking for it (Arruñada, 1999).

When it comes to the non-audit services there are restrictions of how they can be performed, there has to be a strict separations of the employees that do the audit and the ones that do the non-audit services. These restrictions are in Sweden described in the “audit law”, by the professional body FAR and the Swedish supervisory board of public accountants within the ministry of activity (Svanström, 2008). The restrictions tell us what an auditor is allowed to do, which is only to give an audit opinion without any further help whatsoever when it comes to how to manage the errors the auditor discovers (FAR, 2012). The reason for this separation is that the auditor has to be independent in all situations while performing the audit.

As a result of the restrictions of the auditor’s tasks and the demand to a package solution, the audit firms have added consultants, tax experts and professional advisors to their firms. Auditing firms do this to be able to meet the clients request as much as possible and to get as much profit as possible (Tanewski & Carey, 2007). Over the years, audit firms have offered to help their clients with non-audit services matters, it has resulted in a significant part of the audit firms’ profit. Table 2 shows that a large portion of the “Big four” turnover between 2004 and 2010 is in fact non-audit services (2011/1384/SEC final).

**Table 2 – Segments displaying the distribution between consultation and audit of the “Big four”**



Calculations made on the basis of data published in Handelsblatt (2011/1384/SEC final)

For companies to be able to get the range of services that the audit firms provide there is of course also a price. The price of an audit and non-audit services respectively differs depending on what size the audited company is and also how much assistance the company is in need of to complete its errors (Fristedt et.al., 2011). Take for instance PWC which is the audit firm to Ericsson SWE, in the year of 2009 the fees that Ericsson paid PWC for was 108MSEK for the audit and 17MSEK for non-audit services which is 13.7% of the total amount that Ericsson paid PWC for their services. If we look at the company Swedish Match the same years, the audit fees was 14MSEK and 7MSEK for the non-audit services which is 33% of the total amount that Swedish Match paid KPMG for their services (Fristedt et.al., 2011).

Table 2 shows that the non-audit services are a major part of the audit firm’s revenues. When agreeing on the price of the audit, audit firms use the package solution as a tool to come into an agreement with the client of what they can and are willing to pay. Even though the non-audit services may seem to be a positive mutual profit for both the audit firm and the client, several countries have prohibited statutory auditors and audit firms to provide non-audit services besides the audit to the client. If we look at France and the

US where audit firms have been prohibited to provide non-audit services to audit clients, they motivate this as a respond to the financial scandals where the auditor's independence has been questioned (2011/1384/SEC final). As for the rest of the EU-member states besides France, there are no such restrictions on non-audit services yet.

## **Regulations and restrictions on auditors work**

As a result of the Great Recession and several accounting scandals, the EU-commission added new proposals of regulations into the Green Paper<sup>4</sup>, these proposals are known as "lessons from the crisis" (2006/43/EC). The Green Paper proposal on non-audit services was transmitted five years later into an approved proposal as a regulation by the EU-Commission, and had in the fall of 2011 reached its final expected outcome (2011/779/COM final) approved by the European Parliament and the Council. The definition of the final proposal states that: "*a statutory auditor or an audit firm carrying out statutory audit of public-interest entities shall not directly or indirectly provide to the audited entity, to its parent undertaking and to its controlled undertakings non-audit services. Where the statutory auditor belongs to a network, no member of such network shall provide to the audited entity, to its parent undertaking and to its controlled undertakings within the union any non-audit services.*" Further the European Parliament and the Council specifies the proposed regulation of non-audit services in the following list (2011/779/COM final).

### Services entailing conflict of interest in all cases:

- Expert services unrelated to the audit, tax consultancy, general management and other advisory services;
- Bookkeeping and preparing accounting records and financial statements;
- Designing and implementing internal control or risk management procedure related to the preparation and/or control of financing information included in the financial statements and advice on risk;
- Valuation services, providing fairness opinions or contribution-in-kind reports;
- Actuarial and legal services, including the resolution of litigation;
- Designing and implementing financial information technology systems for public-interest entities;

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<sup>4</sup> Green Paper - is a tentative government report and consultation document of policy proposals for debate and discussion, without any commitment to action (BBC news, 2008)

- Participating in the audit client's internal audit and the provision of services related to the internal audit function;
- Broker or dealer, investment adviser, or investment banking services.

Services which may entail conflict of interest:

- Human resources services, including recruiting senior management;
- Providing comfort letters for investors in the context of the issuance of an undertaking's securities;
- Designing and implementing financial information technology systems for public-interest entities;
- Due diligence services to the vendor or the buy side on potential mergers and acquisitions and providing assurance on the audited entity to other parties at a financial or corporate transaction.

The proposal prohibits statutory auditors and audit firms with these above pronounced non-audit services to audited clients. Audit firms that generate more than one third of their annual audit revenues from large public-interest entities and belong to a network, whose members have combined annual audit revenues which exceed EUR 1500 million within the EU, will not be allowed to directly or indirectly provide to any public-interest entity non-audit services (COM/779/2011 final).

The proposal on total ban on non-audit services on these firms has recently been rejected by JURI (the committee of legal affairs) in the EU (as of 2013 April 25). The reasons for this were, as part of a series of measures to open up the market and improve transparency, the committee rejected the proposed prohibition of Big four-only. To preclude conflicts of interest and threats to independence, EU audit firms would be required to abide by rules mirroring those in effect internationally. Most committee members saw the proposed general prohibition of offering non-auditing services as counter-productive for audit quality. They agreed that only non-auditing services that could jeopardise audit quality should be prohibited. They also approved a list of services that would be prohibited under the new legislation. For instance, audit firms would be able to continue providing certification of compliance with tax requirements, but prohibited from supplying tax advisory services which directly affect the company's financial

statements and may be of subject to be questioned by national tax authorities (JURI, 2013).

To prohibit non-audit services is not a recent response to improve audit quality. The US implemented such a prohibition in 2002 with the financial scandals from frauds like Arthur & Andersen and Enron in mind. Their regulation on non-audit services was referred to the (Sarbanes-Oxley act in section 201a)<sup>5</sup>. One year after Sarbanes-Oxley act was introduced, France shared the idea to improve audit quality by prohibiting non-audit services to audit clients. In France this restriction is called (L822-11, Code de commerce)<sup>6</sup>.

## **Problem**

The EU-commission carried out a proposal to restrict the non-audit services to audit clients with purpose to achieve improved audit quality and a more competitive market, which was later approved by the European Parliament. Earlier mentioned as, the non-audit services are a crucial matter for the audit firms' success and a prohibition could therefore harm their success. The opinion divergence to allow or reject these services leads us to the thesis problem: *Why is there an opinion divergence between practitioners<sup>7</sup> and regulators<sup>8</sup> on providing non-audit services to audit clients and its effect of audit quality?*

- Is there a universal definition of audit quality?
- What are practitioners and regulators opinion towards existing regulations of non-audit services?

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<sup>5</sup> Sec 201(a) – is a part of the American SOX, which regulates the prohibition on non-audit services to audit clients

<sup>6</sup> L822-11 – Is part of the French Code de Commerce that regulates the prohibition on non-audit services to audit clients

<sup>7</sup> Auditors, audit firms and professional bodies

<sup>8</sup> The EU-commission and the European parliament

## **Purpose**

The purpose of this thesis was to evaluate the opinion divergence between practitioners and regulators regarding regulations of non-audit services. Our intentions were also to bring some understanding to audit quality and its definition. We found it interesting to bring some clarity into why there is a divergence between practitioners and regulators view of audit quality.

## **Limitation**

We have limited our research down to the countries France (Code de Commerce) the US (Sarbanes Oxley Act) and Sweden. The reason for this is because it is time consuming to find information from all countries in the EU with prohibitions and to find proper information in countries like Italy and Belgium (see appendix 1) where prohibitions already exist. Another issue we encountered were the difficulties we had to obtain information and to get in touch with respondents.

## Theoretical Framework

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*In this chapter we will present several theories connected to our thesis subject, which we later will use as a tool to analyze the thesis problem and empirical findings. The theories we have chosen will be compared to each other, in order to discover similarities and differences in academics opinions to a certain matter.*

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### The Audit Expectation Gap

Before describing the audit firm and its incentives we need to figure out what society expects from the audit firms and their employees, and what the audit firms are able to contribute. The expectation gap was first defined by Liggio (1974), and he defined it as the gap between what the public expects the auditor to do and what the auditor should and can do. Liggios definition was later extended by the Cohen-commission (Car, 1978). The commission was responsible in considering if there was a gap between what the public expects and what the auditor could do (Porter, 1993). Porter (1993) suggests that neither of these two definitions may accomplish expected performance and what they can and reasonable should. Also they do not allow substandard performance. Porter (1993) defined the gap as consisting of two major components:

- A gap between what societies expect auditors to achieve and what they can reasonably be expected to accomplish, (reasonableness gap)
- A gap between what societies can reasonably expect auditors to achieve and what they are perceived to achieve, (performance gap)
  - A gap between the duties which can reasonably be expected of auditors and auditor's existing duties as defined by the law and professional promulgations, (deficient standards)
  - A gap between the expected standard of performance of auditor's existing duties and auditor's perceived performance, as expected and perceived by society, (deficient performance),

See Figure 1.



Figure 1 - The audit expectation gap (Porter, 1993)

## Audit Quality

The appearance of the audit quality can be described in a range from very low to very high audit quality (Francis, 2004). If there is a low audit quality the risk of audit failure will be more frequent (Francis, 2004). The audit failure can be divided into two circumstances, either there can be a question of the general accountancy principles cannot be enforced by the auditor, or when the auditors fail to do the audit report (Francis, 2004). Several of academics, professional bodies and regulators have attempted to define what audit quality really is, but there is no universal definition yet on the definition of audit quality (IFAC, 2011).

Francis (2004) describes the ability to assess audit quality, there is no clear definition of what it is and the only product of an audit is the audit report which makes it difficult to describe audit quality. On the other hand there is easier to lose audit quality when audit failures occur (Francis, 2004). Even though there is no clear definition on the audit quality there is a lot of attempts to assure that the auditors act with high audit quality (Francis, 2004). The stakeholders desire high audit quality and because of that there is a demand for safeguards that can assure that there is high audit quality (Hayes et al, 1999). IFAC (2011) contributes a possible perception of the investors/stakeholders view on audit quality, see figure 2.



**Figure 2 - Possible perception of audit quality through an investor’s lens (IFAC, 2011)**

The stakeholders’ perceptions on the audit quality are dependent on the ability from regulators and contributors of safeguards to assure its existence. The expectations or the auditors’ ability to perform audits and non-audit services with high quality can be drawn to following theories seen from both the regulators and the practitioners perspectives (Hayes et al., 1999). The auditors have these demands on their work, the demands that the regulators and contributors of safeguards perform rules and control the auditors work (Hayes et al., 1999). These perspectives will be described in the following sub categories for each individual theory containing the assumption of ability to achieve sufficient auditing (Hayes et al., 1999).

**The Policeman theory**

Over the last decades the audit business has been “audited”, there have been plenty of new regulations and restrictions on the auditors work. The stakeholders demand the auditor’s independence, and to reactive such guarantee there is laws and regulations on the auditor. The stakeholder has certain expectations on the auditor in many of their decision making processes. The policeman theory describes the auditor’s responsibility to detect and prevent frauds in companies audited (Hayes et al., 1999). This point of view on the auditors work has been the most common since 1940 until 2002. As a stakeholder and possible investor there have to be some sort of risk-guarantee in which the auditor is the main safeguard and protector to prevent stakeholders from investing in a company with an insufficient audit report (Hayes et al., 1999).

## **The Lending Credibility theory**

Porter (1990) developed the Lending Credibility theory which is seen from the management point of view where the author suggested that the management of an entity uses their audited financial statements to enhance the stakeholder's faith in the management. Stakeholders along with others sometimes have to make their judgment based on the financial statements and are therefore obliged to have faith that the audited financial statements is fair and trustful in the matter of the economic situation of the company they want to invest in. However there are other theories such as the "efficient market theory" that states that the Lending Credibility theory and the information that the auditor gives in the financial statements do not necessarily form as a primary basis for investors' investment decisions (Porter, 1990). The stakeholders have needless to say certain expectations from the Auditors to maintain a certain quality in their audit report and in order for the auditors to fulfill these expectations, there are certain safeguards carried out by different professional bodies such as IFAC (2011) and their framework which is establishment by ISA 220 and ISQC 1.

## **The public expectations**

The earlier described theories policeman theory and the lending credibility theory have the common purpose to describe what is expected from the auditor (Hayes et al., 2005). Even though the public needs the auditor to fulfil these expectations they still needs an assurance that the auditor is able to perform these tasks with complete independence, and to not take self interest acts in perspective while performing the tasks (Hayes et al., 2005). The public wants more than just an opinion from the auditors; they want the auditor to act independently and also to perform several kinds of services under the same roof (Hayes et al., 2005). But is it possible to have these expectations and views on the auditor and at the same time be completely assured that there is high audit quality?

## **More than "just" an opinion**

As earlier mentioned, the audit firms have a lot of expectation from its audit clients and that the audit clients will not be satisfied with just the audit opinion on their financial statements, but they rather want a package solution (PWC, 2013; Arruñada, 1999). Therefore the audit business is not just about auditing, it also consists of consultancy, advisory and tax services, which is titled as non-audit services. The consultancy has be-

come to be one of the most important service tools within the audit firm (Salehi, 2011; Tanewski & Carey, 2007). Audit firms are now more an accounting firm that helps the audit clients throughout the whole process, with its financial statements and the approval of the financial statements (Arruñada, 1999; Salehi, 2011; Greenwood et al., 2005).

As earlier said, there has to be a clear separation of the staff performing the consultancy and the staff performing the audit, which is strictly regulated by the accounting law and other directives (Revisorslagen; FAR; Aktiebolagslagen). The auditors only do the audit and the consultants only do the consultancy, but where do we draw the line between auditing and consultancy, and how do we define its objectives and processes. When studying the “Big Four” webpages there is several options of service packages for the client. In the package deal the client can choose one of these packages if desired, this to a fixed price and after the choice the client can add the audit from the same audit firm (PWC, 2013; KPMG, 2013; Ernst & Young, 2013; Deloitte, 2013). Within the package deals there are services that refer to the non-audit services and outside the package is the audit. The benefits of choosing the audit simultaneously as the service package are that the prices tend to be more appealing (PWC, 2013; KPMG, 2013; Ernst & Young, 2013; Deloitte, 2013).

In upcoming subcategories we will describe the non-audit services and their performers, the consultants, and we will also describe the audit services and their performers, the auditors.

### **The consultant and the advisor**

The reasons for accountants and auditors to provide their services under the same roof is because they want to complement each other’s work and being able to provide their clients a package solution, (Arruñada, 1999). What differentiates a consultant and advisor from an auditor is mainly that a consultant can give the entity suggestions and help to perform for an instance the financial statements. Unlike the auditors imitated duties the consultant and the advisors work is not that restricted or regulated by the law, and there is no demand by law to use their services (Abdel-Khalik, 1990).

The audit profession has matured over the years and the audit is under intense competition which has decreased their profit (Beattie et al., 1999). As a result of this, it has be-

come more of a rule than an exception to offer the audit clients a variety of services that extends considerably longer than the traditional auditing (SOU, 1999:43; Tanewski & Carey, 2007). The non-audit services that the audit firms provide consists besides traditional consulting in the field of accounting and tax issues, also includes consulting/advisory within for example business analysis, business development, financial analysis, valuation of company, IT, investments, strategic planning, HR, Installation and implementation of software and hardware and outsourcing of the internal account functions (Elliot & Pallais, 1997).

There is an interest from the clients that the audit firm also provide non-audit services. The benefit to the audit firm is that a combination of audit services and non-audit services is cost effective in the matter that they can use the same information and knowledge in the audit as well as the consultancy assignment (Arruñada, 1999).

Another benefit for the client with this combination is that they can also take part of the audit firm`s competence, especially in the field of the economic area. There has been suggestions that smaller clients/companies have a fundamental need of non-audit services since they don`t have the same possibilities to perform this sort of activities unlikely bigger companies, since they do not have the same possibilities to hire staff or employees for those kind of duties (Johannisson & Lindmark, 1996; Tanewski & Carey, 2007). A crucial benefit seen from the audit firms perspective is the fact that by providing non-audit services, the knowledge of the audited company is much less time consuming since they don`t have to spend that much time to understand the audited entities connection with the non-audit services (Svanström, 2008).

Studies have shown that smaller companies usually hire an auditing firm for non-audit services (Kirby & King, 1997; Bennett & Robson, 1999a; Burke & Jarratt, 2004). There have been studies that suggest that non-audit services gives competence that is crucial for smaller companies` survival and their ability to develop competitive benefits (Gooderham et al., 2004; Santoro et al., 2007). Empirical studies have shown that at least 70% of the companies that hire an audit firm also hire the same firm for non-audit services (Kirby & King, 1997; Bennett & Robson, 1999a; NUTEK, 2000; Gooderham et al., 2004). A possibly explanation to this fact can be that the relation established between the audit client and the audit firm throughout the audit (Svanström, 2008). The established relationship that the audit firm obtained from the audit client during the au-

dit may have an impact on the propensity to ask for non-audit services (Svanström, 2008).

To hire a consultant/advisor for non-audit services is assumed to transfer competence and professionalism that enables development to smaller companies (Svanström, 2008). However Bennet & Robson (1999a) suggest that consulting and advisory is important for the company, but it is not crucial for the company's development. Even though companies utilize non-audit services frequently; they do not consider non-audit services to have a significant impact on the company (Bennet & Robson, 1999a). However there is a risk that the consultant/advisor from the audit firm acts in a self-interest perspective rather than the clients' interests (Bloch, 1999).

Auditors' and consultants' role in smaller companies have been suggested to be manipulated towards an increased use of the audit firm's services (Gibb, 2000). A possible risk could be that the consultant/advisor in advance chose several specific areas to focus on and that the consulting/advisory is not adjusted to the company's actual needs. Instead they point towards maximizing the profit for the audit firm (Mole, 2002). While the consultant and the advisors duties are quite comprehensive and transparent, it is still the auditors' opinion that is final for the company's financial statements, but what does the auditor do to get there?

### **The mystery of the auditor**

The company's stakeholders demand assurance before they are about to do any sort of business with them. It's at this point the auditor appears, like a "ritual priest" he manifests and waves with his magic wand, and the company is "clean" (Pentland, 1993). But what do the auditors really do and why is their opinion so important to the stakeholders along with the rest of us?

Several academics strive to find an answer to why we need auditors and to what they exactly produce (Power, 2003). A common answer to the later mentioned question, what auditors exactly produce, is legitimacy (Power, 2003). That answer usually appears to be the most spontaneous answer to the question, but Power (2003) suggests that an auditor produces paper, and a lot of it. The auditors themselves do not really produce anything new in the form of a physical object or a brand new product. Instead they make their signature that the product that the company themselves has constructed is

fairly stated in all material aspects. However for the auditor to make sure that of this the audit obtains evidence and this is presented on as Power (2003) says a lot of paper. However the production of paper is an important ingredient in the production of legitimacy (Power, 2003). The documentations of the audit routines such as planning and evaluation of the audited company is part of the process to produce the audit report, by gathering a sufficient amount of evidence. By gathering more evidence, the auditor can easier be able to state an opinion and by that opinion produce more legitimacy to the audited company (Power, 2003).

What can be stated from Powers (2003) view on audit procedures is that he sees the auditors work more as routines to produce paper and by that legitimacy while Pentland (1993) on the other hand see the auditors work as something more spiritual where the audit procedure more like rituals with a higher purpose. The different routines and rituals is that routines are something that you do continuously on a daily basis perhaps brush your teeth, this is something that you do without any reflection. Rituals on the other hand is something that has a higher purpose like for instance celebrating a holiday, this is something you do every year but unlike the brush your teeth example the ritual or the holiday in this case is something that has a higher value and will have a higher purpose than your daily basis procedures (Power, 2003; Pentland, 1993).

### **The Independence of the auditor**

Several of the academics and the regulators include independence of the auditors work as an incentive to perform the assignments with high audit quality (Francis, 1994).

The Independence Standard Board (ISB) defines auditors independence as “to be independent, the auditor must be free only from those factors that are so significant that they rise to the level where they compromise or can reasonably be expected to compromise, the auditors ability to make audit decisions without bias that is that the pressures and other factors compromise, or can reasonably be expected to the compromise, the auditors objectivity” (Diamant, 2004).

The only product of an audit is credibility added to financial statements by the audit report (Stettler, 1982). Therefore it is essential that the auditor is independent since no credibility can be added without an auditor’s independence (Stettler, 1982). The relevance of the demand for independence can be explained as when the auditors do their

reports, the auditors express their personal opinion about the audited material which is in line with the existing norms. The auditor's opinion can be affected by other circumstances than what the rules implies concerning the audit (Diamant, 2004).

Diamant (2004) defines independence as the demands that the auditors are expected to follow to receive the demanded impartiality and self-containment. But the definitions of the auditor's independence are many, Vårdal (1987) suggests that the auditor is independent when he or she while performing an audit has the ability and will to make evaluations and decisions based on a foundation of existing facts without letting themselves be affected by others wishes and desires. While the committee CAJEC defines it as: "a state of mind which has regard to all considerations relevant to the task in hand, but no other". These definitions do only take into consideration what the auditor should do to be independent and can therefore be a vague definition of independence.

Lee (1993) suggests that an auditor should claim his/her independent attitude to avoid impact of conflicts of interest. While the actual independence is an act pointed towards the auditors own interpretation and his or her ability to perform the audit, they cannot just act independent to assure that the business is meaningful (Lee, 1993; Diamant, 2004).

Even though the independence of the auditor is quite difficult to define, it is obviously of crucial importance for the auditor's success. The auditor needs to convince the market of his independence as a tool to create a demand for the audit services (Wines, 2011). The independence of the auditor has long been known as the most important professional asset of the auditors, and if the auditor act in a way that diminish he/she will risk getting penalties as well as loss of reputation (Owens, 1941; Johnstone et al., 2001).

Watts & Zimmerman (1986) define the auditors reputation as a collateral bond for independence, in that the reputation for the auditor tend to be diminishing the independent than expected will be harmed and also the present value of the theirs audit services will be reduced. To assure that the auditors is independent there is professional and regulatory bodies that set up requirements, regulations and codes that control the auditors work, with the purpose of securing the independence and safeguard the interest of the stakeholders (Wines, 2011).

## Methods

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*This chapter describes the thesis research approaches and data gatherings as well as issues and thoughts about the data gathering to the thesis empirical findings. It will also tell about the advantages and disadvantages of the selected approaches to be able to perform the thesis studies.*

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### Research Approach

This study applies a qualitative research method. By applying a qualitative method it gave us the opportunity to intervene the thesis problem on a deeper level (Darmer & Freytag, 1995). The thesis applies an comparative case study, where we compare the respondents opinions regarding the thesis problems (Darmer & Freytag, 1995). In some cases there was limited access to information about some of the thesis problems, therefore we used some of our respondents with an explorative approach to get a better understanding in the problem area (Dramer & Freytag, 1995).

Our investigation applies to a case study as a research approach. This design is to prefer for this kind of investigation since it handles occurred events on a deeper level (Yin, 2007). Our motivation for applying a case study approach to our thesis is based on our focus on earlier prohibitions on non-audit services in France, the US and the present proposal to prohibit non-audit services in the EU. In additional we found it interesting to investigate this topic since it is a relevant and current debate, which will affect the entire audit profession within the EU if being adopted.

In this investigation as methodological purpose we chose to use the explaining method, since it proclaims a problem which we have done empirical research on. In additional our intentions were to use the empirical findings to bring clarity to our problem (Yin, 2007).

### Data Gathering

Our intentions were to compare collected evidence and earlier reports, with fresh intake of raw data along with statements from several interview subjects from different positions. By gathering information from both company personnel as well as state-working

staff in the area of accounting and auditing, our intentions were to maintain our neutrality to the research and bring forth the purpose of the essay; *Why is there an opinion divergence between practitioners and regulators on providing non-audit services to audit clients and its effect on audit quality?*

To get more perspective with our thesis subject we read lots of articles with similar or related content. We used these articles to bring some theories into our thesis, and by the use of these theories we were able to bring some understanding to our thesis subject, problem and purpose. Some of the recent written literature contained fresh statistics that were relevant for our thesis. The source we used most frequently was the JIBS library database, Primo.

The internet was our main source for relevant and up to date information about the proposal of the prohibition of non-audit services in the EU and also the already implemented prohibitions in the US and France. All of the “Big four” had something written on their website that was of interest and beneficial for our thesis credibility such as statements and standpoint for each of the firms, when it comes to their thoughts of the regulations the EU-commission has proposed. In addition the EU-commission had surveys with answers from the “Big four”, statistics showing the revenue from audit services as well as non-audit services, diagrams along with their own perspective on the matter. On top of that, we had the schools intranet with several of relevant and up to date thesis related to our thesis.

Our interview surveys were constructed specifically for each of the firms we intended to interview as well as the survey for the EU-commission. We adjusted the survey after what country we sent the interview survey to, this to get as relevant information as possible from the respondents. We attached each of the interview surveys in our appendix. As for the interviews, we had a combination of both telephone interviews along with surveys made over mail with the respondent. Our telephone interview with the EU-commissions Nathalie Berger ended up with a survey interview over the mail with her colleague Paul Fraix. As for the Swedish audit firm respondents we had two telephone interviews and five interviews over mail. In the big picture we had very few telephone interviews but in addition got a sufficient amount of answers on the mail to strengthen the credibility of the thesis in all.

To obtain sufficient information on the thesis empirical findings we took part of professional bodies<sup>9</sup> like IFAC and FAR. The reason why we used their points of view on the EU-commission proposal to prohibit non-audit services to non-audit clients is since they have a good insight in the entire audit business. It is therefore interesting for the thesis purpose. Another reason why we included these points of view was since we troubled major concerns on gathering sufficient information from France and the US, according to their prohibitions on non-audit services. Most of the professional bodies have been closed involved in the audit business over a long range of time and we did therefore use their opinions instead, since they take all matters that have occurred in similar events earlier into consideration, while performing their answers towards the EU-commission proposal.

As a result of the struggle we had obtaining sufficient information from both France and the US; we had to use a lot of secondary data. Secondary data consist of earlier statements from other studies (Jacobsen, 2002). The Secondary data of this thesis is all the answers received from the professional bodies: FAR, IFAC, AICPA, APB and the audit firm Mazars. The information that we were able to receive by ourselves in the empirical finding, the primary data is received by: Nathalie Berger, Paul Fraix, Paul McGurr and the Swedish auditors (Jacobsen, 2002).

### **The thesis reliability**

Gubas and Lincoln (1994) suggest four sub criteria that all of them have as a purpose to explain qualitative studies reliability: Credibility, transferability, trustiness and the ability to prove and confirm. These four sub categories corresponds the more commonly sub criteria internal and external validity, reliability and objectivity (Gubas and Lincoln, 1994). We preferred to use the earlier mentioned sub criteria since we have done a qualitative study, which these criteria are best suited for (Gubas and Lincoln, 1994).

Since we have done interviews, there are several reasons and bases according to why the respondents have answered in the way they did (Gubas and Lincoln, 1994). Some of the respondents may not have answered in an honest way, because reasons like fear to harm the organisation or business and also because of the lack of experience. They sim-

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<sup>9</sup> A professional body is a group of people in a learned occupation who are entrusted with maintaining control or oversight of the legitimate practice of the occupation.

ply gave their spontaneous point of view based on what they had experienced (Gubas and Lincoln, 1994). It was therefore up to us as the authors to separate the information that the responds was containing (Gubas and Lincoln, 1994).

When it comes to the thesis transferability, the thesis empirical findings were in some cases depending on time as well as location. If we ask the same questions at the same audit firm at a later time or at another location, there is a possible risk that we would receive a different answer, since there is a possibility that the question will be answered by a different employee (Gubas och Lincoln, 1985).

When it comes to how this study could be performed in another type of organisation then audit, it is also able to perform a similar study, but instead focusing on the accountancy firms (that do not contain any form of audit), and the consultants. Also the accountancy firms and its consultants and advisors are affected by the regulations on non-audit services, and their business may also change if new regulations on non-audit services were implemented.

## **Sampling Issues**

In the thesis we collected information regarding accounting rules from the countries France and the US. When we searched for information from France we had some difficulties with the language, most of the information was only in their original language (French). This gave us some difficulties to understand the collected data and was therefore forced to use helping devices like Google translate. The problem with Google translate is that the translation usually turns into a quite confusing grammar and reverse sentence which obstructed us to understand the message of the information.

When we were gathering data to the thesis empirical findings we had major concerns of receive the desired amount of relevant information. At first our intentions were to contact auditors from Italy, Belgium, France, Sweden and the US. After several attempts to get in touch with audit firms from the mentioned countries above, we did not received any answers from Italy, Belgium. We had no other choice than to focus on Sweden, France and the US. Even though we chose to keep France and the US in our thesis, the outcomes of relevant information from these two countries was despite several attempts

were close to nothing, as we only received one answer from the US, and a mediocre answer from France.

### **Evaluation of used methods**

The benefits with our research approach were that it gave us the possibility to reach the problematic in an explorative way since there were limited published data that we needed for the thesis subject. When we evaluated our approach to get sufficient information to the thesis empirical findings, it had been better if we were able to get in touch with more auditors from France and the US, since they have a good insight in the matter of prohibitions against non-audit services and audit quality.

If we had succeeded better with getting in touch with more respondents to perform the thesis empirical findings as well as the thesis analysis, it had been more interesting and brought us understanding on a deeper level. When it comes to the thesis interview questions it may have been better if we were more specific in the questions, that may have resulted in more interesting answers on the questions since the most responds we received was quite briefly.

Critique towards our interviews is that the respondents had the opportunity to really think over their answers, and the answers were therefore limited and politically correct. If we had performed face-to-face interview we may have received more interesting and honest answers.

## Empirical findings

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*In this chapter, we will present the thesis empirical findings. The findings consist of responses from Swedish, French and American auditors as well as professional bodies and regulators. Further information about respondents such as profession, nationality and experience is attached in the thesis appendix. The findings will be separated into positive and negative responses to the proposal on prohibition of non-audit services.*

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### **Positive responses on the proposal - related to auditing**

Paul Fraix, desk official at the EU-commission suggests that a regulation on EU-level is necessary since most of the problems in the audit business cannot be solved at a national level. He believes that a regulation on EU-level will enhance the audit quality of the auditors and the audit firms which will lead to better audit environment. Nathalie Berger, head of unit in the field of audit and credit rating agencies at the EU-commission, suggests that the prohibition will increase audit quality of the auditor which she told was a shared opinion with both the stakeholders and the EU-commission.

Fraix suggests that when an audit firm provide non-audit services to audit clients, it has a negative effect on audit quality while performing the self review. What he means is that the audit firm are being placed in a difficult position, where the auditor would need to defend the audited entities view on certain issues. Fraix suggests that this could cause a conflict of interest, since the same audit firm performs and evaluates the non-audit services. Fraix suggest that this may be solved by the prohibition. In additional, he suggests that the auditors have an important role to play in the system but what the auditor does is not always clear. Therefore, a prohibition of non-audit services would help avoiding threats on audit quality and by that enhance the societal role of the auditor. Fraix's final defence as why to implement the prohibition is the inspections reports from inter alia France shows that the audit quality is not a given and that it must be considerably improved.

Paul McGurr, former auditor in the US and also the Netherlands does see the prohibitions on non-audit services in the US as a positive approach. He explains the non-audit services as the major issue both philosophically and practically related to auditors' audit

quality. As response to the questions of the problematic of prohibit non-audit services, McGurr answered by giving an example from an earlier occurrences in the US. He explained that in the late 1980s when Arthur Andersen spun off IT consulting unit to Accenture and Ernst & Ernst (today Ernst & Young) sold their consulting unit to Capgemini. But what happened was that all firms started to rebuild the consulting practices under different names and the problem repeated itself.

Further McGurr believes that auditing should be completely separated from consulting, primarily for independence and audit quality reasons. He does not believe that you can “trust” the auditors to self regulate in connection with independence and audit quality. He suggested that the business model of audit firms makes this a difficult pill to swallow.

### **Negative responses on the proposal – related to auditing**

The Swedish professional body FAR believes that Sweden already has good regulations on the provision on non-audit services to audit clients. Those regulations can be found in statutory audit directive, IESBAs code of ethics and Swedish accountants act. According to FAR, none of these regulators require or even advocate a prohibition of providing non-audit services to audit clients. Instead the regulations advocate a principal based directive to control the auditor’s independence and audit quality, they do not take the size of the client or the fact if the client is a listed or a public interest entity into consideration. FAR believe that a prohibition of non-audit services or some of the non-audit services is unnecessary from an independence perspective. FAR also suggests that prohibit non-audit services will have a negative effect on audit quality and also that the prohibition does not fit well into a principle-based system which is embraced in Sweden.

As for the Swedish auditors’ responses, in the order of respondent A to F. Respondent A claimed that important expertise and knowledge will be lost in certain areas since consultants and auditors will be separated as a result of the provision. Respondent A and F explained that small companies that have neither the economy nor the staff will suffer more than the big companies, since they usually buy their needed services from the same audit firm as a package deal (Consultancy, audit, advisory and tax issues). Re-

spondent B however suggested that it is almost impossible to define the line between auditing and advisory and therefore suggest that instead of prohibiting any non-audit services, there should be improved supervision of audit firms. Respondent C suggests that a prohibition of non-audit services will result in higher prices and more difficulties to all entrepreneurs, which are not in line with today's simplicity trend. This opinion is shared by respondent D and E who both believe that it is up to the client to suggest who they want as an auditor and with this regulation, their choices will decrease, and the costs related to the regulations will exceed the benefits. Respondent E also believes that there should be more restrictions on non-audit services, but to prohibit all non-audit services is quite extreme, which is something that respondent F also agrees with.

At the other side of the Atlantic Ocean, the American professional body AICPA finds that non-audit services issues may be avoided by providing appropriate safeguards and therefore do not see any reasons to prohibit non-audit services. They further believe that non-audit services to audit clients contribute benefits like diversities of skills, efficiency and the quality of the audit. They also believe that to prohibit non-audit services to audit clients will lose the recruitment and retention of high quality professionals.

The professional body IFAC, which supports the audit profession around the world, does not support the prohibition on non-audit services to audit clients, because there is not sufficient evidence that they will have a positive impact on auditor independence and audit quality, and that the benefits will outweigh the risks and costs.

IFAC believes that, performing both audit and non-audit services, audit firms obtain complementary knowledge and competence that ensures each of these services such as tax services and advisory, can be provided efficiently and to the expected quality by following the existing *Code of Ethics for Professional Accountants*.

Paul McGurr believes that there are benefits with combining audit and non-audit services. He says that the obvious benefit is the ability to give full service to a client. The client will then be able to save money because there was knowledge of the company within the audit firm and the client would not have to pay three different firms to have the same knowledge. Plus of course, the synergies in an audit by knowing all the aspects of the firms operations, like the clients' business climate.

## **Positive responses on the proposal - related to other matters**

Paul Fraix believes that the proposals will change the top segment of the audit market. What he means is that, to give SMPs a better possibility to take part of market shares that is held by today's "Big four". He also explains that the proposals do not impose any additional burdens to SMEs that are audited entities as they are exempted from most measures. Some of the proposed measures are also mentioned to decrease market entry barriers, which will have a positive effect on SMPs and facilitate expansions of their activities. Finally Fraix believes that the regulation offers the highest degree of harmonisation between the European and American audit society and would override incompatible provisions in domestic legislation. This idea of harmonisation is also held by his colleague Nathalie Berger.

The American professional body APB believes that (if taking the investors and regulators into consideration) prohibiting non-audit services will give mid-sized accountancy firms an opportunity to provide those services that will lead to a greater competition and choice in the accounting services and audit market.

## **Negative responses on the proposal – related to other matters**

APB (with the auditors taken into consideration) suggests that to prohibit non-audit services will lead to higher costs since if an audit client buys non-audit services and audit from the same company, it will result in less time for briefing and oversight since they are already familiar with each other. APB believes that non-audit services should be allowed since it allows the audit team to have a greater understanding to their client's business climate and risks.

The (Multinational) French audit firm Mazars chairman Patrick de Cambourg states that *"in our view, prohibiting the provision of non-audit services by audit firms would definitely be detrimental to the harmonious development of the single market"*. They believe that an audit today requires a range of skills that, in their view, implies a multidisciplinary approach. Further they believe that if prohibiting non-audit services to audit clients the audit firms would not be able to attract and retain the best talent if they were restricted to pure auditing.

The professional body IFAC believes that the proposed legislation on non-audit services could have a negative impact on the audit profession and PAOs. They explain that

PAOs have in many countries been delegated an important role in regulation, continuing education, discipline, and other areas, and there is an appropriate balance between independent oversight and PAO support. Expertise and infrastructure have been established to support these areas; changes are unnecessary and will require rebuilding infrastructure.

Further IFAC are concerned that the proposal on prohibit non-audit services to audit clients will provide significant problems for global PIEs that require global audit services. IFAC does not believe that requiring firms of a certain size to provide only audit services will enhance global quality and service capability of the profession. They therefore suggest that the EU-commission considers the implications prohibition on non-audit services will have for non-EU states and the global market for audits of multinational companies, like the “Big four”.

### **Recent changes of the proposal**

After our investigation of the matters around the proposal to prohibit non-audit services to audit clients, and the opinion divergence between practitioners and regulators the proposal has changed. As from April 25, 2013 some of the incentives of the proposal were excluded from the reform of the audit market (Brännström, 2013). The committees committee of the EU “JURI” disliked the fact that the proposal involved a total ban on non-audit services regarding the bigger audit firms. JURI (2013) believes that to perform a total ban would be negative on the audit quality since the costs will be severely increased. JURIs scepticism towards the proposal to ban all non-audit services led to a voting and that part of the proposal is now of the table (JURI, 2013).

## Summary

| Entity                     | Positive responses +/- Negative responses   |
|----------------------------|---|
| <b>Professional Bodies</b> | <ul style="list-style-type: none"> <li>+ Greater choice</li> <li>+ Greater competition</li> <li>- Not necessary from an independent perspective</li> <li>- Not a positive effect on the audit quality</li> <li>- Is not suited for a principle based system</li> <li>- Decreased diversities of skills and quality</li> <li>- Costs will overweigh the benefits</li> <li>- Loss of knowledge and competence</li> <li>- More time consuming to briefing and oversight</li> <li>- Less understanding of the clients business climate</li> <li>- Requires rebuilt infrastructures</li> </ul> |
| <b>Swedish auditors</b>    | <ul style="list-style-type: none"> <li>- Important expertise and knowledge will be lost</li> <li>- SMPs will not have the economy or the staff to cover the Costs for an audit along with non-audit services</li> <li>- Higher prices and more difficulties for all entrepreneurs</li> <li>- Choices will decrease and costs will overlap benefits</li> </ul>   |
| <b>The US Auditors</b>     | <ul style="list-style-type: none"> <li>+ Avoid conflict of interest</li> <li>+ Better trust</li> <li>+ Improved independence</li> <li>- The ability to give full services to a client will be lost</li> <li>- Increased costs for audit clients</li> <li>- Lost knowledge and competence</li> </ul>   |
| <b>French Auditors</b>     | <ul style="list-style-type: none"> <li>- It will have a negative impact on the single market</li> <li>- Lost knowledge and competence</li> </ul>  |
| <b>EU-commission</b>       | <ul style="list-style-type: none"> <li>+ Better competition</li> <li>+ Enhanced independence</li> <li>+ Change the top segment (let new competitors in)</li> <li>+ Improved harmonization (between the US and EU)</li> <li>+ Enhance the society role for the auditor</li> <li>+ Strengthen audit quality</li> </ul>  |

Above we have summarized the respondents' primary opinions on prohibiting non-audit services. Both the majority of the professional bodies and the auditors from Sweden and France did have the most negative view on prohibition non-audit services. What we could tell from those responses is that the professional bodies that work with safeguards, guidelines and standards for the audit profession are pleased with the regulation as it is. The professional bodies did not see the point of questioning their capability to provide sufficient safeguards, guidelines and standards to the audit profession. The auditors who desire as much profit as possible do have worries since restricting provision of non-audit services may be an obstacle to achieve this.

## **Analysis**

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*In this chapter, the thesis theories and empirical findings will be woven together to bring clarity upon the thesis problem and purpose, how prohibition on the provision of non-audit services from statutory auditors and audit firms to audit clients with a public interest influence the audit business.*

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### **Safeguards and regulations of non-audit services**

As discussed earlier, the demand for auditing services comes from the desire to facilitate dealings between the parties involved in business relationships such as shareholders, public authorities, employees, creditors and customers (Porter, 1993; Porter, 1990; Hayes et.al., 1999). What each individual parties expects could be described by the policeman theory and the lending credibility theory where we in our theory explained what they desire and expect (Hayes et.al., 1999). The information between such parties is usually costly since it gives rise to uncertainty related to performance of the contractual obligations (Arruñada, 2000). The contractual opportunism along with other instruments and safeguards are used to improve the possible future of performance and demonstrate an urgency to perform to potential contracting parties (Jensen & Meckling, 1976; Porter, 1990). Throughout the whole process there is a demand to assure auditors audit quality by implementing regulations, guidelines and also safeguards contributed by the auditors themselves. The question is how far a regulation can go before its benefits turn into a decreased audit quality?

There have been several studies of auditing at times when crisis have occurred, revealing the true nature of auditors responsibilities and efforts undertaken by the profession to respond to the crisis (Fogarty et.al., 1991). Fogarty et al., (1991); Chandler & Edwards (1996); Humphrey et al., (1992) advice that crises address distinct problems and therefore propose new solutions that may result in an audit expectation gap.

There is a divergent view regarding strength and achievement of audit regulation including faith placed in audit quality. Regulator efforts to provide new regulations are fundamentally flawed (Bazerman et al., 2006; Moore et al., 2006; Nelson, 2006; Robson et al., 2007).

Regulators' attempt to change the audit business was considered to contain widespread rules. Evidence points towards the lack of perceived impact on audit quality, as a result of numerous factors (Beattie et al., 2013). Beattie et al., (2013) suggests that practitioners concerns towards the regulations are based on the high costs for limited benefits. There is an inherent tendency for overconfidence that a useful regulatory intervention exists and regulatory overreaction (Hirshleifer, 2008; Ball, 2009).

Arruñada (2000) suggests that legislators can make as many mistakes in one direction as in the other laying down the rules in either too soft or too severe a manner. If a regulation goes too far, the auditors will tend to carry out defensive audits and only use hard information since this can be used as a defence in litigation (Arruñada, 2000). The auditors will avoid making decisions based on soft information that is not helpful in their defence if the client ends up with problems in the future. If it goes in the other direction that the regulations are too soft, the auditors may give their approval to clients which do not reason in view of their high degree of vulnerability (Grout et al., 1994). It may be at this point when regulations are too weak to assure that the auditors do not act in a self-interest manner, and the possible risks of questionable decisions and fraud.

After the Enron and Arthur Andersen crash in the US, the auditors' work and the audit quality was questioned. That incident among others made the authorities question the capacity and efficiency of auditors' safeguards and they therefore added more severe regulations on the auditors work (SOX, 2002). The benefits of implementing these severe regulations was more overseen and imposed created penalties for managerial misconduct and dealing with the potential conflicts of interest, the Sarbanes-Oxley act aims to prevent that deceptive accounting (Zhang, 2007). Even though it may have those benefits, a severe regulation also comes with some downsides. The business community has expressed major concern about its costs. With all the new regulations on the auditors work like restrictions on the non-audit services has even though its beneficial circumstances, led to an increase in costs for the audit as well as difficulties to meet up with the customers' expectations (Solomon & Bryan-low, 2004; Porter, 1993). The consequences for increased costs for an audit may affect smaller companies since they are less able to bear the gained costs unlike the larger companies (Castellon, 2011; Kirby & King, 1997; Bennett & Robson, 1999a; Burke & Jarratt, 2004). In a survey done by

PWC, PWC found that 59% of the respondents view the risk of overregulation as one of the biggest threats to firm growth (Norris, 2004).

Since 2007 The EU-commission has worked with a proposal on reforming the existing regulations of non-audit services, in a similar way like the Sarbanes-Oxley act. With the Sarbanes-Oxley act outcomes in mind, some of our Swedish respondents have some worries about increased costs of the audit services. When it comes to the matter if it is better to handle regulations and restrictions of the auditors work on a national level or at EU-level, the respondents have differing opinions. Paul Fraix, desk official at the EU-commission stated that he thinks it is necessary to strengthen the regulations on the auditors work in a EU-level while the Swedish professional body FAR do not see the point of doing that, and rather suggest that the EU-level regulations on non-audit services will not be applicable on the Swedish audit business. FAR suggests that existing national rules are more effective, and that the actual safeguards and regulations on a national level are better suited for Sweden.

From the professional bodies in this thesis we have noticed that their opinions differ from the EU-commissions. The fact that their opinions differ does not fit in with Nathalie Bergers statements, that they have taken the professional bodies opinions into consideration while performing the proposals. As Berger told, the professional bodies are those who have the best insights in the auditors work. They also have a greater understanding on how eventual regulations may affect efficiency as well as audit quality.

It was obvious that the empirical findings from the auditors did not prefer the EU-commissions proposal on the non-audit services to audit client, both the Swedish auditors and the French audit firm Mazars have worries on how this will affect the audit business. Bergers explanation as to why the auditors have these objections towards the proposal is that “audit firms who most of all are interested in profit and therefore have a negative position towards the regulation, the auditors resistance to the legislation is that they do not desire an increased competition on an already competitive market”. Since the EU-commission has stated that the most important issue that the proposal on non-audit services deals with audit quality, we do not only see that as the biggest issue that they have to take into consideration. Bergers reasoning about the auditors’ desire for

profit and resistance to gained competition also shows that the EU-commission takes the competition between the auditors into consideration while performing the proposal.

That the EU-commissions proposal on non-audit services to audit clients also handles with competition issues besides the frequently mentioned audit quality also displays in the regulation itself, since the regulation tends to point towards the bigger audit firms. How it shows that it points at the bigger audit firms is in the specifications in the regulation (2011/779/COM), it tells us that only audit firms with a certain revenue are forced to follow the proposed regulation, and also that only those who handle with audit clients with a public interest are concerned by this regulation. That might explain why the “Big four” audit firms have most objections towards the regulation, since it would affecting them the most.

### **What is audit quality?**

There are two key factors within the financial reporting system that an audit is mandated for publicly traded organisations and the fact that their auditors need to be independent as well as in appearance (Diamant, 2004; DeAngelo, 1981; Mautz & Sharaf, 1961). Both these factors of independence are assumed necessary to achieve audit quality. (DeAngelo, 1981; Mautz & Sharaf, 1961). In most audit literature, independence is a given to achieve high audit quality, without any further empirical evidence or logical links (Jamal & Sunder, 2011; Diamant, 2004). One of the reasons that several academics use independence as an incentive to achieve audit quality is based on, its importance on efficient functioning of the capital market, especially with incidents like Enron in mind (Jamal & Sunder, 2011; Owens, 1941; Johnstone et al., 2001).

Since the meaning of audit quality is not defined as a generally accepted term, it leaves room for interpretation (IFAC, 2011; Francis, 2004; Humphrey, 2008). Otto et al., (2009) this suggests that the differences in interpretation and evidence-oriented approaches towards audit quality do not have anything to do with the lack of engagement in intellectual approaches towards audit quality. Soydan (2011) suggests that the interpretation and the debate on how to define like in our case audit quality could be discussed in a political way, where the welfare would have an impact on the final form of the definition. In our case the interpretation of audit quality would then be debated to be defined according to regulators’ view on audit quality or the practitioners.

Humphrey et al., (2011) suggest that a direct correlation between more regulations and high audit quality cannot be assumed. Regulations should be based on a proven advantages rather than the least impact on ruling interests (Humphrey et.al., 2011).

Even though there is to clear definition of audit quality there are several attempts to perform safeguards and regulations to achieve high audit quality (Francis, 2004). IFAC (2011) have some safeguards to assure their view on high audit quality. The framework was established by ISA 220 and ISQC 1, the following areas in the framework are:

- Leadership responsibilities for quality within the firm
- Compliance with relevant ethical requirements
- Human resources
- Acceptance and continuance of client relationships and specific engagements
- Monitoring
- Engagement performance

The EU-commissions' view on audit quality is that it is the auditors' ability to act independently and those auditors do not act in a self interest perspective (COM/779/2011). The thesis respondent Nathalie Berger & Paul Fraix from the EU-commission did frequently use the word independence to describe the incentives of high audit quality.

### **Multidisciplinary firms and audit quality**

Multidisciplinary audit firms have been the case in the audit and accountancy market in the EU over the last decade (Arruñada, 1999; Tanewski & Carey, 2007).). The audit clients as well as clients that ask for consultancy services have more demands on the services that the audit firms provide (Salehi, 2011). Besides from benefits of finding all services that the clients ask for under the same roof there is also a benefit to perform multidisciplinary firms in a knowledge perspective (Tanewski & Carey, 2007). Several of the Swedish auditors from our empirical findings suggest that to perform both auditing, consultancy, advisory and tax services does improve the knowledge within the audit firm. The French audit firm and the American APB do also see the benefits in the matter of improved knowledge and talent within multidisciplinary firms. To prohibit non-audit services or to join the European audit business to clean audit firms will harm important expertise that multidisciplinary firms possesses (De Cambourg, 2011). We believe that knowledge in certain areas will be lost as a result of prohibitions on non-

audit services (Svanström, 2008; Arruñada, 1999). It is most likely that by prohibit audit firms from providing non-audit services will affect the companies knowledge, since a large part of the audit firms supply consists of non-audit services (Svanström, 2008; Arruñada, 1999). If the audit firms are not allowed to include consultants and advisors in the staff, knowledge and expertise will get lost (Svanström, 2008; Arruñada, 1999).

To meet up with the demands that the market requires there is a need to put together all the expertise within the same organisation to be a professional service firm, (Greenwood et al., 2005). To have a wide professional workforce is important for the audit firms' reputation, in their thesis, Greenwood et.al (2005) show that high mobility on the audit firms' human assets makes it dependent on its professional workforce. The biggest professional service firms today are the "Big four" that holds the largest segment of shares and they also have a great reputation, which attracts both clients and employees, Greenwood et.al (2005). If implementing the proposal of prohibition on non-audit services to audit clients, the reputation for the "Big four" risk to be decreased since they will be forced to separate their business into clean audit firms, and by that lose some of the professional workforce that makes them that successful.

Simunic's (1984) claim that the insights learned from performing an audit to a clients can improve the quality of the non-audit services and vice versa. This opinion was shared by the most of the responds from the Swedish auditors as well as the professional bodies FAR and IFAC. What can be drawn from this is that several of the affected by the proposal to prohibit non-audit services to audit clients have concerns about how this can result in a decreased quality and the impossibility to meet up to the audit clients needs. Whisenant et.al., (2003) have in a study of 2666 firms in the year 2000 discovered that non-audit fees do not directly influence audit fees and that audit fees do not directly influence non-audit fees.

The EU-commission motivates in its statements, why they should perform prohibitions of non-audit services regarding the bigger audit firms. One of the statements was that a combination of those two may result in a conflict of interest. The audit firm may take advantages in the pricing since they do have the insight in the client's needs. We find it interesting that their opinion goes in the opposite direction from each other, since Whisenant et.al., (2003) found no direct relationship in conflict of interest related to the com-

combination of non-audit services and audit services to audit clients, whilst the EU-commission use that as one of its arguments. It is also interesting that the EU-commission did find it as a threat to the audit quality, however despite that fact they choose to reject the proposal since JURI found the proposal negative on the audit quality.

The notion that there is no direct relationship between non-audit fees and audit fees vice versa has also been concluded by Krishnan and Yu (2010). They have in their study containing 12000 firms between the years 2000-2006 examined a similar observation as Whisenant, which they did not see the conflict of interest with combining these activities as the Commission claims that they did. A spontaneous question that appears in our minds is then how the EU-commission can find this as a conflict of interest whilst there are several authors that conclude the opposite in their studies?

In the European Parliament assessment paper (2011/1384/SEC final) they argue the above mentioned matter concerning the conflict of interest, they motivate this matter by discovering the outcomes as for instance the US. They do not contribute some evidence or research in their assessment paper to prove this, the fact that they use the US as an motive to the statements does not go in hand related to the outcomes from the results that Krishnan and Yu (2010) and Whisenant et al., (2003) discovered. The reason why we brought this up is since the studies contribution by the mentioned author's takes place in the US, and the studies reach over the years 2000-2006.

### **The relationship between audit quality and non-audit services**

The EU-commissions believe that by prohibiting non-audit services to audit clients will increase the audit quality, since it will lead to higher audit quality of the auditors work, and no risks for conflicts of interest (2011/779/COM final). The interested parties such as stakeholders do not only desire high audit quality and a fair opinion on the entities financial statements but they expect it (Tanewski & Carey, 2007). As discussed in the theory chapter, stakeholders sometimes have to make tough decisions based on nothing but the statements of the entity their interested in investing in (Hayes et al., 2005). However if audit firms only are allowed to make an audit and not consult with the entity currently audited their might arise complications. As several of the Swedish auditor re-

spondents suggested, it is very difficult for an auditor to complain on miscalculations and such to an audited entity without giving them any advice how to repair the damage whatsoever in order to preserve with the eventual regulations. As (De Cambourg, 2011) suggests knowledge amongst auditors in certain aspects related to non-audit services will be lost if there would be a prohibition.

In addition the fact that audit firms will have less time for briefing and oversight since they already are familiar with each other will be affected (APB). This may lead to a lesser quality audit for the entity. What this could lead to is that the audit firms will be more passive and base their audits on severe information only to protect themselves as a safeguard, Arruñada (2000). This does not necessarily harm or benefit the auditor's in audit quality in any way, but instead creates a more formal relationship between the audit firm and the audited client. FAR believes that the EU-commissions' regulations will have no impact on the audit quality, which may be based on similar views. As mentioned earlier respondents from Swedish audit firms believe that it will be difficult to withdraw from giving audited entities helpful information on how to fix certain issues in their financial statements. But then again, this does not necessarily jeopardise the auditor's audit quality, since the auditor should follow strict regulations and therefore not consult with the audited entity, Arruñada (2000).

The approach that the auditor will have towards the audited company will if anything strengthen the credibility of the opinion in the long run if they approve the financial statements, since their decisions is based only on severe information, not only is this comforting for the stakeholders but it also helps the auditor to maintain their credibility. But once again, it does not necessarily have to have any impact on the auditor's audit quality since they could still have personal interest in the entity audited. However, Stettler (1982) suggests that credibility cannot be achieved without audit quality from the auditor which contradicts with the statements from professional bodies, Arruñada (2000).

Mazars who is an audit firm from France but consists in several countries suggests that a prohibition on non-audit services will enable regular and fair tendering, (De Cambourg, 2011). By fair tendering Mazars says that *“There should also be full disclosure of the links between the audited entity and the auditor to counter institutional bias fa-*

*vouring the dominant firms*” (Herbinet, 2013). This may at first be seen as something positive especially from small audit firms’ point of view, but Zeff (2003b) suggests that tendering of audits results from the deregulation of the profession to strengthen competition and to reduce perceived monopoly pricing of an audit. By inviting clients to actively tender audit firms for provision of audit services at a competitive cost, may create a fair market opportunity for SMPs to compete with the larger audit firms. But on the other hand, it may cause damages on the SMEs if audit firms no longer are allowed to provide non-audit services included in the audit (Kirby & King, 1997; Bennett & Robson, 1999a; Burke & Jarratt, 2004)

Craswell (1992) showed that there is an aggregate of negative aspects that could occur such as an increase in the frequency of auditor switches and fee reductions. In addition the client may give their current auditor an advantage in the bidding process that may create a potential corruption hank (Menezes et al., 2003). Menezes (2003) suggest that the auditor in return could give the client a favourable report which may lead to a corrupted and blighted audit quality from the auditor. However Arruñada (1999) suggest that clients assess the clear advantages from a joint service provision since it will lower the number of providers, lower costs, better quality and a better guaranteed audit quality.

Jamal & Sunder (2011) did a comprise study on multidisciplinary firms and clean audit respectively consultancy firms. What they found in their study was that the market is dominated by the multidisciplinary firms and the clean firms have major problems to find customers in this market to grade inflation and providing low quality services, (Jamal & Sunder, 2011). Surprisingly, strict grading and restricting scope of non-audit services do not go together (Jamal & Sunder, 2011). What can be drawn from this is that non-audit services contribute significant value to the firm and without these non-audit services, firms will most likely experience difficulties competing for market shares (Abdel-Khalik, 1990; Gooderham et al., 2004; Santoro et al., 2007; Kirby & King, 1997; Bennett & Robson, 1999a; NUTEK, 2000; Svanström, 2008).

The Oxera report (2006) argues about difficulties that might exist for audit firms to penetrate the audit market. As with almost everything, the capital is a vital issue that might prevent especially smaller audit firms from potential entry barriers. Example of such issues might be the inability for smaller audit firms to raise funds to finance expan-

sion and as a result of this, their potential entry barrier is in “danger” due to necessary investments that might not be executed. However there are other major potential entry barriers examined in the reports such as the quality of the staff and the brand/reputation, neither of which indicates decreased costs for audit firms (Oxera report, 2006). This contradicts Arruñadas (1999) suggestion that it will lower costs for especially SMPs firms in that matter.

## **Discussion of audit quality and non-audit services**

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*In this chapter we will discuss matters relating to non-audit services and audit quality. With this discussion we briefly point out the matters and results we achieved while performing the thesis interviews as well as the analysis. We did this to narrow it down to our final conclusion in the next chapter.*

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By investigating the EU-commissions proposal on prohibition of non-audit services to audit clients, it contributes inputs to answer reasons for the opinion divergence relating to the definition on audit quality. The discussion of in which matter the non-audit services impair audit quality is a recent ongoing process, which we found useful to use as source to investigate the thesis problem.

While performing our interviews we discovered that auditors tend to only name the benefits with providing non-audit services, and its effect on the audit quality. We believe that the reason for this is that since the non-audit services is that a major part of the audit firms' revenues, which we displayed in Table 2. Another reason for the auditors' negative response towards the proposal to prohibit non-audit services is a big part of the audit firms today is so called multidisciplinary firms and that the proposal to joint the bigger audit firms would completely change the business and thereby audit quality according to the thesis empirical findings. This while the respondents from the EU-commission only name the benefits with prohibiting non-audit services to audit clients, since they found it as a serious threat to the auditors' independence, and thereby audit quality.

We discovered that audit quality was a frequently mentioned defended to the practitioners and the regulators beliefs, both factions used it to explain why prohibitions of non-audit services would harm respectively improve auditors work. As stated in the thesis analysis, there is no universal definition of audit quality, and we see this as one of the reasons to why practitioners and regulators have such different views on it.

## Conclusions

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*In this chapter we will present the thesis conclusions, this by using the analyzed empirical findings and theories. By using that information our intentions were to bring some clarity upon the thesis problem: “Why is there an opinion divergence between practitioners and regulators on providing non-audit services to audit clients and its effect on audit quality?”*

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Evidence indicates that there are numerous different practitioners and regulators that have tried to claim what audit quality is, both factions use audit quality as arguments to why the audit profession should be performed after their individual interpretation. We believe that this creates a conflict of interest since there is no clear universal definition of audit quality. In our empirical findings, regulators believed that the outcome of providing non-audit services is a threat to audit quality, and they tend to focus on the independence of the auditors when they describe what creates audit quality. Practitioners tend to define the outcome from non-audit services as a contributor to high audit quality since it allows shared knowledge within the firm, easier understanding of the clients’ environment and lower costs for audit/non-audit services to the client.

Our empirical findings indicate that practitioners have major objections towards the EU-commission’s proposal to prohibit non-audit services to audit clients. Several of the practitioners found the proposal a serious threat to audit quality since valuable knowledge in certain areas would be lost. The regulators argued that practitioners’ objections towards the proposal are based on their desire to make profit. We believe that since there is no definition of audit quality it creates a dispute between the parts, where both regulators and practitioners chose to define audit quality based on their own interests. We believe that this creates an opinion divergence between practitioners and regulators.

We believe that an interesting matter is the EU-commission’s proposal on a separation of non-audit services and audit services regarding the “Big four”, which they believed would be a major contribution for high audit quality, was down voted by JURI who claimed that the outcome of such prohibition would not benefit the costs. JURIS concern was in line with the practitioners’ opinion in our empirical findings. Since there is

no universal definition of audit quality it seems to us as a waste of time to try to regulate auditors work with purpose to achieve high audit quality.

Finally, we believe that in order to resolve this conflict of interest related to the interpretation and definition of audit quality, there is a need to agree on a universal definition of audit quality. To be more particular a definition that leaves no room for ambiguities and misinterpretation from both practitioners and regulators. We also believe that a universal definition on audit quality will help society understand both practitioners and regulators work since with a clear definition, their work may become more transparent.

### **Theoretical contribution**

This thesis contributes understanding to why there is an opinion divergence between practitioners and regulators. It points out the need to state a universal definition on audit quality to be able to evaluate the audit business as well as get rid of ambiguities and misinterpretations between practitioners and regulators.

### **Further research**

Since there is no universal definition of audit quality, we believe that it would be beneficial for both practitioners and regulators to perform studies regarding a universal definition on audit quality. Does a universal definition on audit quality necessarily have to be a good thing? A research whether a definition of audit quality is good or bad would be something interesting to examine.

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## Appendix

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*In this chapter did we put in the thesis empirical journals, interview questions and information about the respondents, and other matters that we did choose to not to put into the thesis.*

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### Appendix I - The thesis empirical Journal

- Mail to Nathalie Berger (head of unit in credit and auditing in the EU-commission) [2013-02-14]
- Mail to 7 employees on the Swedish supervisory board of public accountants within ministry of activity [2013-02-14]
- Mailed 8 Swedish PWC offices with an request to get in touch with an auditor in PWC Italy, PWC France and PWC US [2013-02-14]
- Mailed 8 Swedish Ernst & Young offices with an request to get in touch with an auditor in Ernst & Young Italy, Ernst & Young France and Ernst & Young US [2013-02-14]
- Mailed 8 Swedish Deloitte offices with an request to get in touch with an auditor in Deloitte Italy, Deloitte France and Deloitte US [2013-02-14]
- Mailed 8 Swedish KPMG offices with an request to get in touch with an auditor in KPMG Italy, KPMG France and KPMG US [2013-02-14]
- Mailed Paul McGurr with request on an interview [2013-02-14]
- Mailed questions to PWC Sweden, Ernst & Young Sweden, KPMG Sweden, Deloitte Sweden and BDO Sweden (5 auditors of each firm), and confirmed an interview with Nathalie Berger[2013-02-18]
- The Swedish supervisory board of public accountants within ministry of activity declined to participate.[2013-02-20]
- Mailed the French, Italian and American embassy regarding questions about regulations on auditing in respectively country and also if they could help to get an touch with an auditor. [2013-02-20]
- Received answer from Italian embassy, they told us that they had transmit our questions [2013-02-21]
- Nathalie Berger could not answer any of our questions, referring only to the EU website, where none of the information we were looking for is available, she referred us instead to his colleague who helped set up the proposal on "prohibit non-audit services", we contacted him by email and wait for response. [2013-02-21]
- Received 7 answers on the questions out of 20 from the big four [2013-03-01]
- With no further success to get in touch with an auditor in France, Italy and the US we tried to get in touch with an audit office through JIBS university partners in respectively country (contacted 15 universities in the US, 8 in France and 4 in Italy) [2013-03-04]
- Neither of the partner universities were able to help us [2013-03-20]

- No one from Italy or Belgium did choose to answer our questions or agreed on an interview. [2013-03-20]
- With no further success to get in touch with an auditor in Italy and Belgium we choose to limit the countries in the thesis to only the US, France and Sweden [2013-03-21]
- Neither of the contacted “Big four” offices were able to help us with our request [2013-03-21]
- Received an answer from Paul Fraix (the contact Nathalie Berger recommended) and received a more useful answer [2013-03-24]
- Received answer from Paul McGurr, he agreed to answer some questions over email [2013-04-01]
- Paul McGurr answered some of our questions, but did not have the insights and knowledge that we desired [2013-05-03]
- The French auditor declined her participation in our thesis [2013-05-06]

## Appendix 2 – The Swedish auditor respondents

| Respondent | Title                | Experience | Audit firm      |
|------------|----------------------|------------|-----------------|
| A          | Accountant assistant | 3 years    | Big four Sweden |
| B          | Authorized auditor   | 14 years   | Big four Sweden |
| C          | Approved auditor     | 7 years    | PwC Sweden      |
| D          | Approved auditor     | 7 years    | Big four Sweden |
| E          | Authorized auditor   | 9,5 years  | Big four Sweden |
| F          | Approved auditor     | 12 years   | Big four Sweden |
| G          | Approved auditor     | 24 years   | Big four Sweden |

## Appendix 3 - Swedish auditors interview questions

*EU-kommissionens förslag på nya revisionsregler innebär bland annat totalförbud för revisionsbyråer att erbjuda sidotjänster (med sidotjänster menar vi alla tjänster ni erbjuder utöver revisionen) till era klienter. Vad tycker du om förslaget?*

**Svar:**

*Hur tror du att Er byrå kommer påverkas ifall förslaget verkställs?*

**Svar:**

*Hur tror du oberoendet och revisionens kvalitet påverkas av sidotjänsterna? Vad kan vara problematiskt och hur hanterar du tänkbara problem?*

**Svar:**

*Hur viktigt är det samt hur gör du för att skapa och behålla förtroendet till intressenterna? Hur tror du sidotjänsterna påverkar förtroendet?*

**Svar:**

#### **Appendix 4 – French interview questions**

*The EU-commissions has proposed to prohibit non-audit services of audit firms to their clients, in the entire EU. What do you think of that proposal?*

**Answer:**

*In which directions has the French prohibition of non-audit services (code de commerce L822-11) affected the business market? (negatively/positively, in which ways)*

**Answer:**

*How do you think non-audit services affect the independence? What can be problematic and has the prohibition helped to prevent the problematic?*

**Answer:**

*After interviewing several Swedish auditors, we can summarize that most of them suggests that to prohibit non-audit services will decrease the competence within the organisation, since the knowledge will be separated. Is this something you have experienced in France?*

**Answer:**

*Since there are regulations against non-audit services in France (code de commerce L822-11), could you see difficulties with similar regulations in the entire EU?*

**Answer:**

*How do you as an auditor maintain your independence?*

**Answer:**

*Do you have any insights on the reactions to the implementation of the “code de commerce L822-11” on non-audit services (Both from organisations and auditors)?*

**Answer:**

#### **Appendix 5 – American interview questions**

*How do you think the Sarbanes-Oxley Act (SOX) sec.201 (prohibition of non-audit services) has affected the audit profession?*

**Answer:**

*Has the auditors' independence been compromised since the implementation of the regulation SOX sec.201?*

**Answer:**

*Since there are regulations against non-audit services in the US, could you see difficulties with similar regulations in the EU?*

**Answer:**

*Do you think that non-audit services have a significant impact on the audits independence?*

**Answer:**

*How do you as an auditor maintain your independence?*

**Answer:**

*Do you have any insights on the reactions to the implementation of the SOX sec.201 on non-audit services (Both from organisations and auditors)?*

**Answer:**

*What is your opinion on the regulation SOX sec.201?*

**Answer:**

## **Appendix 6 – Paul McGurr interview questions**

*Could you tell us briefly about your carrier as an auditor? What where the biggest differences to be an auditor in the US compared to the EU (Netherland)?*

**Answer:**

*What where efforts as an auditor to be independent, and how did you maintain your independence?*

**Answer:**

*Do you think it's possible as an auditor to not give any advises?*

**Answer:**

*Do you think that non-audit services have a significant impact on the auditors' independence?*

**Answers:**

*What where the reactions to the SOX sec.201 and how did it affected the audit business, negatively or positively?*

**Answer:**

*Have you worked as an auditor after the implementation of SOX sec.201, if so, did it make it more difficult to be an auditor?*

**Answer:**

*What is your opinion on the SOX sec.201? Do you think it's justified to separate auditing and consultancy? If so, why?*

**Answer:**

*Do you think that a prohibition on non-audit services to audit clients will improve the auditor's independence? Why, why not?*

**Answer:**

*In the JIBS webpage it tells that you were active as an auditor until 1990 when the Sarbanes-Oxley Act 2001 haven't occurred yet, which were the benefits to have both consultancy, tax services, advisory and audit within the same audit firm?*

**Answer:**

*Do you think it's a good idea for the EU-commission to do a similar prohibition as the SOX sec.201?*

**Answer:**

*Do you have any insights on the reactions to the implementation of the SOX sec.201 on non-audit services (Both from organisations and auditors)?*

**Answer:**

*Do you have any former auditor colleagues in the states that worked during the implementation and/or after the implementation of SOX sec.201? If so, we would appreciate if you could give us their email so we could ask them as well about these questions. If it is not possible to get in touch with them, did you get any insights from your former colleagues while SOX sec.201 was implemented, and what was their thoughts about the regulation?*

**Answer/Email:**

## **Appendix 7 – EU-commission interview questions**

*According to the EU-Commission in the field of auditing, there are a few strategic directions that are being pursued such as:*

- Independence of audit firms and auditors*
- Auditor's liability*
- Public oversight of auditors*
- International standards on auditing*
- Co-operation with third countries*

*Could you tell us more specific about how you work towards these strategic directions?*

**Answer:**

*While you developed the process of the regulations related to the non-audit services, was there anything in this process that stood out or was different from the ordinary?(Like problems to fulfil some of the steps with this regulation)*

**Answer:**

*If you choose to proceed with this regulation, what problems and difficulties did you take into consideration during your process?*

**Answer:**

*Have you taken into consideration how an implementation of this regulation will affect the smaller audit firms, which usually only have few smaller clients that most of the times need a lot of non-audit services beside the audit?*

**Answer:**

*Did you use any experiences from Italy, France, Belgium (and the US) from when they developed their process to prohibit non-audit services? If so, did they have any problems after the implementation, and how did they deal with it?*

**Answer:**

*Why did the EU-commission make a proposal to prohibit non-audit services? (were there any specific reasons for it based on occurred events)*

**Answer:**

*Have you learned anything from the regulation from prohibiting non-audit services from countries like Italy, France the US and Belgium? If so, is there any documentation of the effects of implementing the regulation like progresses and responses that we could take part of or that you could refer us to? (Besides the “Lessons from the crisis” document and your webpage)*

**Answer:**

*Why did it take such a long time for the EU-Commission to do the similar propose on non-audit services as the Italy, France, (the US) and Belgium did for more than ten years ago? Did problems occur for them during and after the implementation that made you more cautious? And if so, what kind of problems?*

**Answer:**

*We have examined a considerable number of responses from audit firms view of the regulation and we have noticed that most of them, especially the big 4 speaks well of and are positive towards regulations at the beginning but tend to change their thought later on in their response and be more negative. Considering the negative attitude towards the regulations, what were the arguments to “ignore” these thoughts and proceed with the regulations anyway?*

**Answer:**

*Have the regulations that the EU-commission made been influenced by the Sarbanes Oxley act section 201 about prohibition of non-audit services in the US? Since the US have had this regulations for over a decade (is this perhaps a way to strive towards harmonisation between countries and continents)*

**Answer:**