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## **AUDITORS' INDEPENDENCE: AN OVERVIEW**

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### **ABSTRACT**

*The immediate role of audit independence is to serve the audit, and the objective of the audit is to improve the reliability of information used for investment and credit decisions. Improvements in the reliability of corporate disclosure reduce the risk that an investor or creditor will make a poor decision because the information is inaccurate or otherwise wanting in quality. Auditors' independence refers to the independence of the external/ statutory auditors. The basic definition of audit is 'independent appraisal of accounts by third party'. Therefore, the two terms 'audit' and 'independence' are inseparable. Auditors' independence is necessary not only for the purpose of obtaining assurance on the financial statements, but also to prevent financial misstatement/ fraud. The recent corporate scams in India and abroad have demonstrated that lack of auditors' independence played a major role for occurrence of those scams. The lack of independence of the auditors is widely debated and it is very often questioned whether in actual practice there is independence or not. The auditor should be independent from the client company, so that the audit opinion will not be influenced by any relationship between them. The auditors are expected to give an unbiased and honest professional opinion on the audited financial statements presented to the shareholders of a company.*

*In the above background this paper tries to make an overviews in respect of auditor-independence. This paper is divided into eight sections: 1: Introduction, 2: Research Methodology, 3: Objective of the Study, 4: Review of literature 5: Theoretical Framework of Auditors' Independence, 6: Auditors' Independence of some developed countries 7: Conclusion 8: Limitations of the Study.*

**KEY WORDS-** Auditor, Audit Opinion, Auditor Independence, Corporate disclosure.

## 1. INTRODUCTION

The auditing profession has at present revised its method of work from the last century. In the early part of the twentieth century, the emphasis in auditing was on the detection of error and fraud by massive checking of entries in the books of accounts. The growth in the size of the business entities and the mechanization and computerization of accounting records, he made this approach increasingly realistic. The profession has responded by switching the emphasis of its auditing procedure from massive checking of individual items to establishing whether the organization have realizable system. The modern audit has increasingly concerned itself with establishing that the annual accounts have been prepared from a reliable accounting system on which a prudent auditor can reasonably place reliance and then with thoroughly testing and reviewing the final account themselves. Moreover the profession is now going beyond the duties prescribed on it by the Companies Act in that it is initiating its own accounting standards and auditing regulations and guidelines. At present it has sought to standardize the accounting procedure by issuing mandatory accounting standards and also by issuing standardized auditing guidelines for conducting audit work.

An independent audit is an examination of the financial records, accounts, business transactions, accounting practices and internal control of a charitable nonprofit by an "independent" auditor. Independent refers to the fact that the auditor is not an employee of the nonprofits but instead is retained through a contract for services and hence is "independent" During the independent audit the auditor will review the organization's financial statements to determine whether they adhere to GAAP. These accounting principles are created by the "Financial Accounting Standard Boards" known as FASB.

The definition of independence does not require the auditor to be completely free of all the factors that affect the ability to make unbiased audit decision but only free from those that rise to the level of compromising that ability. Independence means, by which the statutory auditor demonstrates that he can perform his task in an objective manner. In dealing with independence it is necessary to address both independence of mind that is the state of mind which has regard to all considerations relevant to the task in other hand independence in appearance that is the avoidance of fact and circumstances which are so significant that an informed third party would question the statutory auditor's objectivity. Auditor independence helps to ensure quality audits and contributes to financial statement users' reliance on the

financial reporting process, thus increasing capital market efficiency. Auditor independence is often referred to as the cornerstone of the auditing profession.

There are three main ways in which the auditor's independence can manifest itself.

- Programming independence
- Investigative independence
- Reporting independence

**Programming independence** essentially protects the auditor's ability to select the most appropriate strategy when conducting an audit. Auditors must be free to approach a piece of work in whatever manner they consider best. As a client company grows and conducts new activities, the auditor's approach will likely have to adapt to account for these. In addition, the auditing profession is a dynamic one, with new techniques constantly being developed and upgraded which the auditor may decide to use. The strategy/proposed methods which the auditors intend to implement cannot be inhibited in any way.

While programming independence protects auditors' ability to select appropriate strategies, **investigative independence** protects the auditor's ability to implement the strategies in whatever manner they consider necessary. Basically, auditors must have unlimited access to all company information. Any queries regarding a company's business and accounting treatment must be answered by the company. The collection of audit evidence is an essential process, and cannot be restricted in any way by the client company.

**Reporting independence** protects the auditors' ability to choose to reveal to the public any information they believe should be disclosed. If company directors have been misleading shareholders by falsifying accounting information, they will strive to prevent the auditors from reporting this. It is in situations like this when auditor independence is most likely to be compromised.

## 2. RESEARCH METHODOLOGY

This is a conceptual study based on secondary data which were collected from Books, Journals, Websites, Documents, Reports, Ph.D. thesis, Acts, Regulations etc.

## 3. OBJECTIVES OF THE STUDY

- (i) To study the theoretical framework of auditor independence.
- (ii) To study regulatory provisions regarding auditor independence of some developed countries.

#### 4. REVIEW OF LITERATURE

**Beattie Vivien, Fearnley Stella and Brandt Richard (2005)** in their article “Auditor Independence and Audit Risk in the UK: A Reconceptualisation” discusses the principles-based UK regulatory framework for auditor independence (ICAEW 2001), adopted in 1997, identifies threats to both to independence in fact and in appearance and the safeguards which control these threats. These principles are incorporated in the IFAC (2001) ethics framework. In few case studies of interactions involving significant accounting issues between audit engagement partners and finance directors in UK listed companies, they analyse the threats and safeguards to auditor independence in fact which are relevant to the outcome of each interaction. Poor outcomes arise where the safeguards are insufficient defence against the threats. The frameworks do not recognise that threats can arise from within the audit firm and that corporate governance is not necessarily a safeguard. Threats which arise from within the audit firms are not recognised in the current audit risk.

**Dart, E. (2011)** in his article “UK investors’ perceptions of auditor independence” discusses current UK regulations highlighted that economic dependence, non-audit service provision and long tenure had the potential to damage auditor independence. Concerns regarding auditor independence have once again arisen because of the recent banking crisis in the UK. UK investors are most concerned about the threats of economic dependence and non-audit service provision, and are relatively unconcerned about the threat of long audit tenure.

**Stevenson, Joanna E. (2002)** in his article “Auditor Independence: A Comparative Descriptive Study of the UK, France and Italy” discusses the issue of statutory auditor independence across three EU Member States: the UK, France and Italy, by comparing the ethical guides and the legal and professional regulations in place, highlighting and discussing areas of divergence, and contrasting them with the EC’s Consultative Paper.

**Wan Hua Lan, Georgakopoulos Georgios, Sotiropoulos Ioannis, Galanou Ekaterini (2010)** in their article “Main Principles and Practices of Auditing Independence in China” discusses the main factors affect auditor independence in China audit market. They identify not only non-audit services and price cutting affect the auditors’ independence but also regulation affect the auditors’ independence. They also mention other some factors affect the auditors’ independence such as reputation, competition, audit firm size ect.

**Maity. B.K (Aug.2014) Maintaining Auditor Independence In India: A study of the current regulatory environment** in this book the author mention that independence is fundamental to the

delivery of quality audit, the auditors play a very important role in enhancing the creditability of the information presented in financial statements. Without independence auditors can’t give a reliable information on the financial position and performance of the company.

**Garcia-Blandona Josep, Ma Argiles Josep” (2015)** in their article “Audit firm tenure and independence: A comprehensive investigation of audit qualifications in Spain” discusses the effects of audit firm tenure on independence ,while measuring independence using the audit report opinion with a sample of Spanish public companies. Their results show that auditors seem willing to sacrifice independence in lengthy engagements, but only for non-going-concern modified opinions. They concluded that the auditor independence would be impaired in lengthy engagements.

**DeFond, L. Mark, Wong,T.J, Li. Shuhua (2000)** in their article “*The impact of improved auditor independence on audit market concentration in China*” discuss the effects of implementing rigorous new auditing standards in China. The adoption of the new auditing standards, in the presence of costly penalties for non-compliance, provides an incentive for auditors to become more independent.

#### 5. THEORETICAL FRAMEWORK OF AUDITORS’ INDEPENDENCE

An audit is an independent appraisal of the financial records, accounts, business transactions, accounting practices, internal control and applicable rules and regulation of an entity.

##### **Conceptual basis for a framework for auditor independence**

The Financial Accounting Standards Committee of the American Accounting Association believes the following characteristics should underlie a conceptual framework for auditor independence. These characteristics are - (A) characteristics of persons associated with or affected by auditor independence, (B) characteristics related to consequences of auditor independence, and (C) characteristics related to the evaluation of auditor independence.

##### **(A) Characteristics of persons associated with or affected by auditor independence**

(i) The framework should recognize that independence resides in persons. An independence framework should distinguish the auditor from his/her firm and should acknowledge that the individual auditor faces incentives and penalties that may differ from those facing the audit firm as a whole.

(ii) The framework should recognize that the entity whose financial reports are the subject of the audit is not a natural person (i.e., the client) with a unique state of mind.

(iii) The framework should recognize that the benefits of auditor independence depend on the perceptions of individuals who rely on auditors' decisions. These perceptions include both those related to various factors that create and mitigate bias in auditors' decisions and those related to the importance of independence to the overall quality of auditors' decisions.

**(B) Characteristics related to consequences of auditor independence**

(iv) The framework should recognize that the relevant consequence of auditor independence is its effect on auditors' decisions.

(v) The framework should acknowledge that auditor independence has both benefits and costs. Such an approach would recognize that auditor independence is not an objective in and of itself, but is desirable if it improves the quality of auditors' decisions and the decisions of individuals who rely upon auditors' decisions.

(vi) The framework should recognize that the quality of auditors' decisions is influenced by both their independence and competence (expertise). Specifically, in the assessment of the benefits and costs of auditor independence.

**(C) Characteristics related to the evaluation of auditor independence**

(vii) The framework should evaluate auditor independence in terms of observable factors that are likely to influence whether an auditor's decisions are unbiased, rather than in terms of unobservable factors, such as an auditor's state of mind.

(viii) The framework should evaluate an auditor's independence in terms of a continuum (i.e., the degree of independence), rather than as a dichotomous variable (i.e., an auditor is either independent or not independent).

According to IFAC, independence is of two types- (i) independence of mind and (ii) independence in appearance. PCAOB of USA also has issued documents on the concepts of independence of auditor.

**5: Auditors' Independence of some developed countries**

**5.1: U.S.A**

American Association of Public Accountants (AAPA) was formed in 1887. At that time its byelaws did not have any provision regarding independence of auditors. In 1916, the AAPA was replaced by the Institute of Public Accountants (IPA). In 1917 the name of Institute of Public Accountants (IPA) was changed to American Institute of Accountants (AIA). During the first quarter of twentieth Century, there were debates on independence of public accountants. In 1926 the Committee of the AIA raised the question whether a public accountant, who has financial interest in a company, should attest balance sheet of that company. Subsequently many articles in journals

addressed the issue of independence of auditors, but it was not included in the Rules of Professional Conduct. In 1933 American Institute of Accountants adopted a resolution that the function of an auditor in dual capacity i.e. in the capacity of an auditor as well as in the capacity of a director/ officer of an enterprise is against the interests of the stakeholders, and it impairs the independence of auditors. Independence is an essential condition in the relationship between auditor and client (Younkins, 1983). However action was not taken by the Institute on this resolution.

The concept of independence was not considered as important till the enactment of two Acts namely- Securities Act of 1933 and Securities Exchange Act of 1934. These two Acts were passed after the great economic depression and following share market crash in 1930. These Acts incorporated the requirement of certification of statements / accounts by independent public or certified accountants. In 1933 a Rule passed by the SEC provided that a public accountant will not be considered independent if he has interest, directly or indirectly, in that company in which he is auditor. In 1934 an AIA resolution prohibited a public accountant having substantial financial interest to take up audit of that corporation. In 1937 SEC issued Accounting Series Release No. 2. It provided specific cases where independence is affected. In 1940, AIA adopted a Rule which replaced its 1934 resolution. In 1942 this Rule was amended. Financial interest of his immediate family members was also included for the purpose of determination of independence. Several Accounting Series Release of SEC addressed the issue of auditor independence. Accounting Series Release 47, issued in 1944, discussed 20 cases where auditor's independence was found to be impaired.

In 1947 specific definition of auditor independence was framed by AIA. It defined independence "as state of mind". It emphasized on "independence in fact" rather than "appearance of independence". Since there were much debate on the term "substantial" financial interest prescribed by AIA for assessing independence, SEC deleted the word "substantial" in 1950 from its documents. In the meantime in 1957 the name of AIA was changed to American Institute of Certified Public Accountants (AICPA).

The Public Oversight Board (POB), formed by AICPA in 1977, was an independent private sector body to oversee SEC Practice Section. Its role was to oversee and report on the work of the auditors who were registered with Securities Exchange Commission (SEC). It issued reports like- *In the Public Interest: Issues confronting the Accounting Profession* (1993), *Strengthening the Professionalism of the Independent Auditor* (1994) etc. In 1998 POB appointed a

Committee on Audit Effectiveness. The Committee submitted its report in 2000. In addition to its regular duties, the POB's main activities in 2001 and 2002 were implementation of the recommendation of the Committee on Audit Effectiveness. In 1999 SEC requested POB to undertake special review of SEC Practicing Section Firms. This special review of POB was stopped due to cutoff of funding to the POB. Later on when this review was started again, it received poor response from the accounting firms. In this background POB voted to terminate the existence of POB in January 2002.

### 5.2 Canada

Canada's audit oversight institutional framework has been strongly influenced by the division of powers between the federal and provincial jurisdictions under its federal constitutional system. In Canada, the Canadian provinces and territories are responsible for securities regulation. To ensure a national approach to the oversight of the audits of publicly listed entities, the Canadian Securities Administrators (CSA), the Canadian Institute of Chartered Accountants (CICA) and the Federal Superintendent of Financial Institutions created the Canadian Public Accountability Board (CPAB) in 2003. The CPAB is a federal not-for-profit corporation. It was not possible to establish CPAB as a statutory body because of the federal-provincial jurisdictional arrangements in Canada.

Canada has adopted a combination of a principles-based and rule-based approach to ensure independence of auditors. Auditors must identify threats. If threats are material, they will either take steps to reduce those threats to an acceptable level or will refuse to continue the audit engagement if reduction of threats is not possible. Most of the conflicts in auditor's independence arise when the auditor provides non-audit services to his clients. Canada prohibits providing non-audit services by the auditor of the same company. In Canada, proper combinations of rules & prohibitions and threats & safeguards, have created an effective ground for independence of auditors. (<https://www.cpacanada.ca/-/.../enhancing-audit-quality-Canadian-perspectives-auditor-independence-summary-of-responses-to-the-discussion-pap...> accessed on 31.3.18)

### 5.3 United kingdom

The UK's financial sector has been the subject of frauds and crisis during every decade since the 1970s. The crisis has been fuelled by neoliberal ideologies which emphasise light-touch regulation, individualisation, excessive faith in markets and pursuit of private profits, with little regard for social consequences. Auditors are expected to flag matters of concern to shareholders and regulators. The general setting within which audit decisions are made and

independence perceptions are formed is evolving rapidly due to competitive and regulatory changes. Policy-makers must work continuously to evaluate the critical threat factors and develop appropriate independence principles. The European Union (EU) is trying to establish a common set of independence principles. The potential of recent regulatory reforms in the United Kingdom, many of which are unique to that country, are to strengthen the independence framework. UK legislation (the Companies Act 2006) requires Institute of Chartered Accountants of England and Wales and others to adopt, in the matter of auditor independence, the Ethical Standards issued by the Auditing Practices Board (APB) for Auditors – now the audit and assurance function of the Financial Reporting Council (FRC). Therefore, while performing audit function in accordance with the ISAs (UK and Ireland), auditors are required to comply (by S290 of the ICAEW Code) with the requirements of the APB's Ethical Standards. According to APB, its Ethical Standards are more restrictive than that of the *International Ethics Standards Board for Accountants* (IESBA) (and therefore ICAEW) Code.

The UK framework for independence adopts an integrated principles-based approach. (This differs from the approach taken by the SEC where the four principles set out are not actually part of the rules themselves). The said framework recognizes threats and safeguards with respect to independence. Subsequently, European Commission's (2001) and IFAC's (2001) frameworks took similar stand on threats & safeguards. However, the frameworks made distinction between independence in fact & independence in appearance, and gave emphasis on independence in appearance. Five main threats to independence were identified by UK, EC and IFAC.

The Institute of Chartered Accountants in England and Wales (ICAEW) has a Code of Ethics for their members based on a set of rules that require accountants to evaluate and address threats to independence. The ICAEW has revised its Code of Ethics, effective from January 1, 2001. ([eprints.gla.ac.uk/482/1/Audrisk21June\\_03.pdf](http://eprints.gla.ac.uk/482/1/Audrisk21June_03.pdf) accessed on 29.3.18). This revision is based on the code of the IESBA of IFAC. It may be mentioned here that the ICAEW is a member of IFAC. The salient features of codes of ethics are:

1. The Code is of much importance to the chartered accountants in their every professional activity. The conceptual framework contained in Part B of the Code applies not only to General Application but also in case of certain public practice of the professional accountants.
2. Auditor independence is described in Part B of the Code (Section 290). It prescribes that the members of the Institute shall comply with the APB's Ethical

Standards while conducting audits in the country.

3. The Code also provides guidelines for non-audit services to a client by the professional accountants in the line of the IESBA code. (<https://www.icaew.com/membership/regulations-standards.../code...b/part-b-290> accessed on 29.3.18)

#### 5.4 Australia

Australia has a federal constitutional system. It has been able to achieve a national system of corporation regulation as a result of an agreement between the Australian Government and the Governments of the States and Territories involving the referral of powers to the Federal Government. Another important feature is that the Federal Parliament has made provision in the Corporations Act detailing the requirements for independence of the Australian auditors. Australia, as well as USA, has adopted common standard of auditor independence which incorporates both the concepts of independence of mind and independence in appearance. The Australian general requirements and Securities Exchange Commission's (SEC) requirements of auditor independence are very close to each other.

The Australian Accounting Standards Board, and the Auditing and Assurance Standards Board of the Australian Accounting Research Foundation are responsible for the development of financial reporting and auditing standards and guidance, respectively. The professional bodies, CPA Australia and The Institute of Chartered Accountants establish the ethical rules and professional requirements. These requirements recognize that the objectives of the accountancy profession are to work to the highest standards of professionalism; to attain the highest levels of performance; and generally to meet the public interest requirement. Australia has not imposed a legislative ban on non-audit services. ([https://archive.treasury.gov.au/.../Australian\\_Auditor\\_Independence\\_Requirements.pdf](https://archive.treasury.gov.au/.../Australian_Auditor_Independence_Requirements.pdf) accessed on 28.3.18).

#### 5.5 Japan

Historically, the audit profession in Japan developed under strong government leadership over the last fifty years in order to promote sound development of the Japanese capital market. The first group of professional accountants in Japan is said to have emerged around 1907, but it was not until 1927, when the Accountants Law was enacted, that a fledgling institute of professional accountants came into existence. However, the formal institutionalization of the profession had to wait for the enactment of the CPA Law (as amended) in July 1948. The Japanese Institute of Certified Public Accountants (JICPA) started in 1949.

The establishment of JICPA was made under the CPA Law (Article 43, (1) of the CPA Law). JICPA is the only professional accounting body in Japan. It was originally formed in 1949 as a voluntary body, and was reorganized in 1966 into its present form requiring every CPA in practice to become a member of the Institute. The most important role of JICPA is to keep a register of CPAs.

(<https://www.albany.edu/acc/AccountDptmt/Research/pacificrim/japan.html> accessed on 31/3/2018)

JICPA develops the Code of Ethics for its members. In 2000, JICPA's annual assembly approved a revision of the Code of Ethics that was proposed by the Enhancement of Professional Ethics Project Team in JICPA. The new Code of Ethics -"Code of Ethics for Professional Accountants" (revised in 1998) is harmonized with the code of the International Federation of Accountants (IFAC). Further development of the Ethics Code is under way in the newly established Independence Study ad-hoc Committee, in order to reflect IFAC's new principle-based independence rules, which were announced in 2001. The Code of Ethics prescribes that "Certified Public Accountants have a duty to perform their work with professional competence, integrity and objectivity to benefit the public interest and to contribute to the development of a sound society as professionals in auditing and accounting," and requires CPAs to have integrity, objectivity, professional competency, due care, confidentiality and professional behavior. (<https://www.coursehero.com/.../3-3-The-Code-of-Ethics-JICPA-develops-the-Code-of-Ethics-for-its-members-In/> accessed on 28.3.18)

#### 5.6 China

In light of the global economy, China has performed a series of financial reforms. The latter are different from these undertaken in Eastern Europe that mainly copied and applied western-style market systems. The work undertaken in the country is more experimental and it has aimed at improving performance rather than thoroughly changing the financial system. China's reform path is more akin to grow out of the reform plan (Naughton 1994). In China, accounting profession was established in 1918. Four Chinese CPA firms were founded in the 1920s and until 1947 there were 3,356 registered professionals in the country (Gensler and Yang 1996). ([citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.675...](https://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.675...) accessed on 26.3.18)

However, after the revolution of 1949, the role of auditing in the national economy significantly changed. The socialist government established a single "publicly owned" economy, centralized business management, and controlled all economic resources. By 1956, the audit practice had been replaced by a system of specialist supervision and internal

accounting control (Xiao *et al.* 2000). After the economy was nationalized in 1962, the audit function performed by public accountants was annulled (Gensler and Yang, 1996). In 1970 China followed the Soviet model. However, the implementation of this crude system failed to reflect and capture the complex nature of modern transactions and the contemporary business concept of the accounting system. A group of badly trained professionals performed the detailed recording of transactions. These professionals were the first accountants in the country with no related education and/or appropriate training (Graham 1996). Till the early 1990s, the audit practice was still directed and regulated by the State. There are two organizations reporting separately to the Council of the State. One is the Ministry of Finance and the other one is the State Audit Administration (Winkle *et al.* 1994). The auditing system in China has, in very few occasions, served the purposes of financial position reporting. The system was employed instead to collect data that were used to monitor compliance with State aims and for tax purposes (Lau and Yang 1990).

The numerous regulations introduced by the government with regards to the Chinese financial system require the involvement of independent auditors in order to implement the associated economic measures (Tang *et al.* 1992). The first stage in audit reforms started in the 1980s. Following economic advancement, foreign investors entered the Chinese market mostly in the form of joint ventures. The foreign enterprises had a different capital structure from the domestic (state-owned) ones. Thus, the 1985 Regulation was established with the purpose to harmonize the Chinese reality with the international practice by formulating financial reporting (Chow *et al.* 1995). The 2nd phase was started in the beginning of 1990s. With the establishment of the Shenzhen Stock Exchanges (SZSE) and the Shanghai Stock Exchanges (SSE) China completely changed its accounting system. To improve auditor independence, the Chinese government adopted three sets of auditing standards in 1995, 1997 and 1999 respectively. These standards were patterned after the International Auditing Standards (IAS). ([https://www.researchgate.net/.../44444753\\_Main Principles and Practices of Auditing Independence in China: A Multifaceted Discussion](https://www.researchgate.net/.../44444753_Main_Principles_and_Practices_of_Auditing_Independence_in_China:_A_Multifaceted_Discussion))

### 5.7 India

In India not much emphasis was given on auditor independence. The Companies Act, 1956 had some provisions to safeguard the independence of company auditors in India. This Act maintained double standard on the issue of auditor independence. Whereas auditors of Government companies are appointed by Comptroller and Auditor General (C & AG) on rotational basis (of three years) with full

independence, auditor of private sector companies were being appointed by the shareholders (de facto by the company management) in Annual General Meetings without any rotational system, thus having limited independence. Only at the time of removal of auditor by a private sector company, the auditor had some safeguards in the Act of 1956, so that the auditor cannot be removed easily. Also, Section 226 of the said Act imposed barrier on the appointment of a CA as auditor of a Company if he is:

- (a) an employee or officer of the Company;
- (b) a partner of a person who is employee of an officer or of an employee of the Company;
- (c) a person who owes to the company an amount in excess of Rs. 1000;
- (d) a person who is guarantor or security provider to a third party in connection with debt to the company for an amount in excess of Rs. 1000;
- (e) a person who is holder of any security of that company.

On the abovementioned grounds if a person is disqualified from becoming auditor of a company, he will be also disqualified to become auditor of such company's subsidiary, co-subsiary or holding company.

Provision related to Audit Committee was incorporated in the 1956 Act in 2000 for some specified companies. The Audit Committee has some indirect role in ensuring independence of auditor.

The Institute of Chartered Accountants of India (ICAI) issued a Guidance Note on Independence of Auditors in 1968. This Guidance Note was revised in 2005. Quoting the IFAC document it states that threats to auditor independence are- (i) Familiarity threats, (ii) Self-interest threats, (iii) Advocacy threats, (iv) Intimidation threats and (vi) Self-review threats. This Note discusses- the provisions contained in the Companies Act, 1956, provisions contained in the Chartered Accountants Act, 1949, Chartered Accountants Regulation 1988 and Code of Ethics which protects the independence of auditors. The Guidance Note concludes that in the opinion of the Council both the Companies Act, 1956 and the Chartered Accountants Act, 1949 have sufficient safeguards so far as auditor independence is concerned.

The claim of the Guidance Note was found to be hollow when the Satyam scandal came to light in 2009 and the auditor (Price Waterhouse) was also found to be responsible and the partner and the audit firm was punished. Lack of independence of the auditor was evident from the facts of the case.

The Companies Act 2013 has made some important changes in respect of auditor independence- (i) In case of private sector listed companies, auditor shall rotate every five years if auditor is an individual, and every ten years if auditor is a firm.

- (ii) Prohibited rendering of eight types of services by the company auditor to its audit client-
- (a) book keeping & accounting
  - (b) internal audit;
  - (c) financial information system- design and implementation
  - (d) actuarial
  - (e) investment advisory
  - (f) investment banking
  - (g) financial
  - (h) management, and
  - (i) any other prescribed services
- (iii) Compliance of Auditing Standards was made mandatory.
- (iv) Heavy penalty to be paid by the auditor for non-reporting of fraud
- (v) Constitution of National Financial Reporting Authority (NFRA), which is empowered to oversee the quality of service of the professions. It replaces existing National Advisory Committee on Accounting Standards to make recommendations to the Central Government on laying down auditing and accounting standards applicable to companies. NFRA to monitor and enforce compliance with auditing and accounting standards. NFRA will have the power to make orders imposing penalty for professional or other misconduct by the auditors. Also it shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit.
- (vi) Power of the Tribunal to remove auditor in case the auditor acted in fraudulent manner.
- (vii) Class action suit against the auditor also for misstatement in audit report.
- (viii) More power to Audit Committee
- (ix) Punishment for fraud in case of misstatement in Audit Report
- (x) Responsibility on the auditor to report as to presence of adequate internal financial control and their effectiveness.
- (xi) Restricts the number of audits to 20 companies (all total) by an individual auditor
- Rule of Professional Conduct formulated by the ICAI and the Chartered Accountant Act play very important role in the matter of ensuring auditor independence. The SEBI Act, 1992 also has various provisions that are aimed at safeguarding independence of company auditor. Clause 49 of the SEBI listing Agreement puts emphasis on better corporate governance & financial disclosure.
- One dark side of auditors' independence in relation to Bank Statutory Audit is the Finance Ministry's guidelines stating that bank management can appoint statutory auditors after getting a nominal approval from the Reserve Bank of India. Since the work of the management is being audited, it is highly objectionable

to allow choosing one's own auditor. It is like allowing an examinee to choose his own examiner.

## 6. CONCLUSION

From the study we found that all the countries we studied put emphasis on independence of auditors. It is true that there is variation amongst the countries in this respect. IFAC has issued the Code of Ethics for Professional Accountants, and it discussed the term independence. The IFAC document is a very important guideline on ethical issues, including independence, for professional accountants all over the world. In U.S.A two Acts were passed after the great economic depression and share market crash in 1930, namely Securities Act of 1933 and Securities Exchange Act of 1934 but those Act not consider the concept of independence. In 1947 AIA framed a specific definition of auditor independence. The Sarbanes-Oxley Act (SOX) was passed by US Congress in 2002. The Act has devoted nine sections (201 to 209) on Auditor Independence, which prescribes dos and do not's for public accounting firms. The Act also provided for creation of a Public Companies Accounting Oversight Board (PCAOB). PCAOB is has very important role in to oversee the audits of listed companies.

Canada has adopted a combination of a principles-based and rule-based approach to ensure independence of auditors. Most of the conflicts in auditor's independence arise when the auditor provides non-audit services to his clients. Canada prohibits providing non-audit services by the auditor of the same company. In Canada, proper combinations of rules & prohibitions and threats & safeguards, have created an effective ground for independence of auditors.

The UK framework for independence adopts an integrated principles-based approach. UK and IFAC identified five main threats to independence or objectivity. The Institute of Chartered Accountants in England and Wales (ICAEW) has Code of Ethics for their members. The members have to assess and address threats to independence based on rules framed for the purpose.

Australia, as well as USA, has adopted common standard of auditor independence which incorporates both the concepts of independence of mind and independence in appearance. The Australian general requirements and Securities Exchange Commission's (SEC) requirements of auditor independence are very close to each other.

It is found from the study that Australia and the US have adopted a general standard of auditor-independence incorporating the concepts of independence of mind and appearance. Canada, the EU and the UK have not adopted a general standard of auditor-independence along the lines of the Australian and SEC requirements. The UK framework for

independence adopts an integrated principles-based approach.

China, a socialist country, also recognizes the importance of auditor independence. Starting from 1980s it has adopted a series of measures for independence of auditors. Presence of foreign capital in the country has made the government alert in this respect.

The Institute of Chartered Accountants of India (ICAI) issued a Guidance Note on Independence of Auditors in 1968 which was revised in 2005. The Companies Act 1956 had some safeguards to protect independence of auditors. The Companies Act 2013 has made many important changes in respect of auditor independence. It is true that in India not much emphasis has been laid on this issue, in comparison to advanced countries. Particularly the role of GoI in relation to appointment of bank statutory auditors is a reactionary step so far as the independence of auditors is concerned.

## 7. LIMITATION OF THE STUDY

Our study has some limitations also. Following are the limitations of our study

- a) We considered only seven countries. Taking more countries into consideration for the study will definitely give better picture.
- b) The Study is based on secondary data only.

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### Acts:

- The Chartered Accountants Act, 1949
- The Companies Act 1956
- The Companies Act 2013.