



Non-Audit Service Provision and Its Effect on Auditors' Independence and Audit Quality

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Abstract

This research examines auditors' perceptions on the provision of non-audit services (NAS) to audit clients towards auditor independence and audit quality. It is a descriptive study that mainly investigates whether auditors perceive the provision of NAS to impair their independence, enhances audit quality, or whether it has no effect on auditor independence. This research utilized a questionnaire that was sent to external auditors that are currently working in public accounting firms in Indonesia. Seventeen auditors responded to the online survey. It was found that auditors somewhat perceive the provision of NAS to impair their independence, as well as enhance audit quality. In addition, they disagree that it has no effect on independence. Moreover, this study found no significant difference in auditors' perception when gender, working experience, position, educational background, the experience of NAS provision, and age group were considered.

Key words

Audit Quality, Auditor Independence, Non-Audit Service Provision, Indonesia.

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1. Introduction and literature review

One of the most highly debated audit independence issues has been the provision of non-audit services (NAS) by audit firms to their audit clients. Strong arguments have been made that such services create an economic bond between auditor and client, impairing an auditor's independence. On the other hand, equally strong opinions have been expressed that the provision of NAS increases an auditor's knowledge of the client's business, resulting in a more effective audit. Empirical studies of the potential relation between audit quality and NAS levels have found little, if any, evidence to support the former position, and some evidence to support the latter opinion (Causholli *et al.*, 2015).

During the last 20 years, various NAS rendered by auditing firms have emerged and have been widely adopted by companies around the world. This was due to the expansion and complication of the globalization, spreading of multinational companies, and the improvements in information technology (Khasharmeh & Desoky, 2018). The U.S. regulators have stated nine types of NAS services, which include bookkeeping, design, and implementation of financial information systems and valuation services or fairness opinions, internal auditing services, planning of human resources, actuarial services, and legal services (Sarbanes & Oxley, 2002). Nowadays, many companies have acquired NAS services such as computer hardware and software installation, human resources planning, bookkeeping, tax return preparation, investment banking, internal audit out-sourcing, and finally, management advisory services (Jenkins & Krawczyk, 2011). Furthermore, according to Brierley & Gwilliam (2003), since the globalization in

accounting and assurance service, it has formed ‘the multidisciplinary nature of audit firms’ which would present audit and NAS to audit clients. Therefore, Quick & Warming-Rasmussen (2005) argued that the practice had become one of the significant issues concerning the possible auditor independence dilemma.

The extension of NAS services to the clients has raised inquiries about whether auditing firms can sustain their independence while offering NAS to audit clients. Without independence, an audit cannot achieve its goals, which is the essential requirement for an auditor to be able to perform an audit. The auditor in public practices must be free of bias with respect to the client and must be recognized as independent by users of the audit report. Performing audit and NAS for the same client might cause a lack of independence for the auditor, because this may create a working relationship that is too close between the auditor and the client. Lindsay *et al.* (1987) investigated the influence of providing a number of services (i.e., preparation of accounts, executive search, and accounting systems design) on auditor independence in the Canadian environment. They concluded that accounting systems design was seen as the smallest threat to auditor independence. However, they found that about a third of the respondents considered the other two services, preparation of accounts and executive search, to be making an auditor dependent on the client. This expansion of services is expected to improve the firm’s competitiveness, maintain continuous growth, and satisfy customers. In line with this, Khasharmeh & Desoky (2018) also found that the majority of German auditors believed that auditor independence would be abused when auditors offer widespread accounting consultancy or services.

This study is conducted to provide empirical evidence on NAS provision toward auditor’s independence. Furthermore, this study also investigated the impact of providing NAS upon the quality of the audit. This study contributes to the accounting and auditing literature by filling the gap in the existing literature because there are only a few publications that directly investigate NAS provision in developing countries such as in Indonesia. Hence, this study focuses on investigating the perceptions of external auditors working in public accounting firms in Indonesia on the issue of providing NAS to an audit client and its influence upon auditor independence and audit quality. More specifically, the hypotheses of this study are as follows:

H_{a1} : Provision of NAS impairs auditor independence

H_{a2} : Provision of NAS enhances audit quality

H_{a3} : Provision of NAS has no impact on auditor independence

H_{a4} : There is a significant difference between auditor perception when the auditors are grouped according to gender, working experience, position, educational background, the experience of NAS provision, and age group.

2. Methodology of research

This study aims to examine the effect of NAS provision to audit clients on auditor independence and audit quality. It involves a survey of auditor perception using an online questionnaire. The online questionnaire is prepared using Google form, and the link was sent through social media. It is distributed to external auditors who are currently working in public accounting firms in Indonesia. Using the convenience sampling technique, the questionnaire is sent to whomever the researcher has access. However, given the limited time and contact, only seventeen auditors responded to the questionnaire sent.

The questionnaire is adopted from Khasharmeh and Desoky (2018). It comprises of three sections, in which Section 1 (i.e., questions 1 to 11) measures whether the provision of NAS impairs the auditor independence, Section 2 (i.e., questions 12 to 22) measures whether the provision of NAS improves audit quality, while Section 3 (i.e., questions 23 to 26) measures whether the provision of NAS does not affect auditor independence. The questionnaire utilizes a five-point Likert scale (i.e., 1 = strongly disagree, 2 = disagree, 3 = somewhat agree, 4 = agree, and 5 = strongly agree). The demographic section is also included to examine whether different perspectives may be attributed to gender, working experience, position, educational background, the experience of NAS provision, and age group.

3. Results and discussions

3.1. Demographic Data of the Respondents

Demographic analysis in Table 1 shows that a total of seventeen external auditors responded to the online survey. Among the respondents, nine (52.9%) are female, and eight (47.1%) are male. Table 1 also shows that majority of the respondents have been working as an auditor for less than five years (i.e., twelve respondents or 70.6%) and they are in the position as a junior auditor (i.e., ten respondents or 58.8%). Most of the auditors have a bachelor's degree (i.e., twelve respondents or 70.6%). The majority are never engaged in providing NAS to their audit clients (i.e., eleven respondents or 64.7%), and most of them are in the age group of 21 to 30 (i.e., eleven respondents or 64.7%).

Table 1. Frequency Analysis

Variable	No of Respondents	Percentage
<u>Gender</u>		
Female	9	52.9
Male	8	47.1
Total	17	100.0
<u>Working Experience</u>		
< 5 years	12	70.6
5 - 10 years	3	17.6
11 - 20 years	2	11.8
Total	17	100.0
<u>Position</u>		
Junior Auditor	10	58.8
Senior Auditor	3	17.6
Audit Manager	3	17.6
Partner	1	5.9
Total	17	100.0
<u>Educational Background</u>		
Bachelor	12	70.6
Masters	4	23.5
Others	1	5.9
Total	17	100.0
<u>NAS Provision</u>		
Yes	6	35.3
No	11	64.7
Total	17	100.0
<u>Age Group</u>		
21 – 30	11	64.7
31 – 40	6	35.3
Total	17	100.0

3.2. Auditors' Perceptions

Before verifying the hypotheses, the reliability test was conducted to check the internal consistency of the questionnaire. To measure the reliability of items in the questionnaire, Cronbach's alpha test was performed. The results in Table 2 shows that the Cronbach's Alpha of the 26 items in the questionnaire is 0.837, which is higher than 0.7, the general rule of thumb. Therefore, it can be concluded that the questionnaire is highly reliable in measuring auditors' perceptions on the effect of NAS provision to the audit client.

Table 2. Reliability Test

Cronbach's Alpha	N of Items
0.837	26

3.3. Descriptive Statistics

Table 3 presents the descriptive statistics on each question in the questionnaire, classified by the three sections. Based on the decision criteria, the mean score greater than 3 indicates that the statement is essential as perceived by the auditors. Under Section 1, Q6 received the highest mean score (i.e., 3.94), indicating the importance of this question. Respondents perceived “an auditor should not be allowed to participate in the foundation of the corporation that is being audited by him or to be a member of an administrative or advisory position.” Q14 and Q20 under Section 2 received the highest score (i.e., 3.47); they respectively indicate that auditors highly regard “the provision of NAS activities enhances the auditor’s ability to learn more clients, thereby helping to ensure that they satisfy their obligation to conduct a better audit,” as well as “certain frauds might have been prevented or detected if NAS had been provided to the client or if better communication had occurred between NAS personnel and the audit engagement team.” Under Section 3, Q24 received the highest mean score (i.e., 3.29), indicating the importance of this particular question, among others. Auditors perceived “the provision of NAS does not necessarily damage auditor independence or the quality of NAS.”

Given that the data is not normally distributed, non-parametric tests were used to verify the hypotheses. In particular, the significant difference in auditors’ perception is tested using the Chi-Square for one sample test. Most of the Chi-square for the 26 questions is not significant ($p > 0.05$) except that of Q2, Q3, Q4, Q9, Q16, Q20, and Q24. This indicates that most of the responses are equally dispersed among the different levels of agreement.

Table 3. Descriptive Statistics per Question

Questions	N	Min	Max	Mean	SD	Chi-Square	df	Asymp. Sig.
Q1	17	2	4	2.71	0.849	2.941	2	0.230
Q2	17	1	5	2.59	1.004	13.294	4	0.010
Q3	17	1	5	2.65	0.931	12.706	4	0.013
Q4	17	1	4	2.71	0.772	9.118	3	0.028
Q5	17	1	4	2.71	0.849	5.353	3	0.148
Q6	17	2	5	3.94	1.029	5.353	3	0.148
Q7	17	1	5	3.24	1.147	4.471	4	0.346
Q8	17	1	4	2.18	0.883	4.412	3	0.220
Q9	17	2	5	3.18	0.809	8.176	3	0.043
Q10	17	3	5	3.82	0.809	0.824	2	0.662
Q11	17	2	5	3.41	1.176	0.176	3	0.981
Q12	17	2	4	3.29	0.686	3.647	2	0.161
Q13	17	2	5	3.35	0.996	2.059	3	0.560
Q14	17	2	5	3.47	0.943	3.471	3	0.325
Q15	17	1	4	2.76	0.970	3.000	3	0.392
Q16	17	1	4	2.06	0.827	8.176	3	0.043
Q17	17	2	5	3.41	1.004	3.000	3	0.392
Q18	17	1	4	2.65	0.996	2.059	3	0.560
Q19	17	1	4	3.06	0.966	4.412	3	0.220
Q20	17	2	5	3.47	0.874	8.176	3	0.043
Q21	17	1	4	2.88	1.111	3.000	3	0.392
Q22	17	2	5	3.47	0.943	3.471	3	0.325
Q23	17	1	4	2.65	1.169	0.647	3	0.886
Q24	17	1	5	3.29	0.985	9.765	4	0.045
Q25	17	2	5	2.82	0.951	6.294	3	0.098
Q26	17	1	4	2.94	0.966	3.471	3	0.325

The descriptive statistics for each section can be seen in Table 4. It is shown that Section 1 has a mean score of 3.011, with a standard deviation of 0.560. This means that the respondents somewhat agree that the provision of NAS impairs auditor independence, which supports the first hypothesis. The standard deviation is less than half of the mean, which means that there is no dispersion among auditors’ perceptions regarding the impact of NAS provision on auditor independence. This particular result supports the study of Joshi, Bremser, Hemalatha, and Al-Mudhaki (2007) and Khasharmeh and Desoky (2018), which also found that the provision of NAS impairs auditor independence.

Table 4 also shows that Section 2 of the questions has a mean score of 3.080 and a standard deviation of 0.560, which is also less than half of the mean. This particular result indicates that auditors somewhat perceive the provision of NAS to enhance audit quality, which supports the second hypothesis. There is also no dispersion found among auditor’s perception on this matter. On the other hand, section 3, as shown in Table 4, has a mean score of 2.927, with a standard deviation of 0.695, which is also less than half of the mean. The mean score is the lowest among the three sections. This indicates that auditors disagree that the provision of NAS has no impact on auditor independence; thus, the third hypothesis is not supported. There is no dispersion found on the perception of the auditors.

The Chi-square of each section is not significant (p -value > 0.05), which means that the answers are equally distributed among different levels of agreement criteria. Overall, based on the results of the three sections, auditors support the argument that the provision of NAS impairs auditor independence (Section 1), and improves audit quality (Section 2). However, they disagree that the provision of NAS has no impact on auditor independence (Section 3).

Table 4. Descriptive Statistics per Section

Section of Questions	N	Min	Max	Mean	SD	Chi-Square	df	Asymp. Sig.
Section 1 (Q1-11)	17	2.18	4.27	3.011	0.560	2.059	11	0.998
Section 2 (Q12-22)	17	1.73	3.82	3.080	0.560	3.588	9	0.936
Section 3 (Q23-26)	17	1.75	4.00	2.927	0.695	5.765	8	0.674

3.4. Correlation Analysis

The Pearson Correlation coefficients in Table 5 show that there is no significant correlation between the demographic variables (i.e., gender, working experience, position, educational background, the experience on NAS provision, age) and the three sections of questions. The small sample size might affect the results.

Table 5. Correlation Coefficients

	Gender	Exp.	Position	Education	Provision	Age	Section 1	Section 2	Section 3
Gender	1	0.120	0.044	-0.045	-0.044	0.044	-0.157	0.255	0.409
Exp.	0.120	1	.718**	.785**	-.629**	.629**	-0.126	-0.202	0.033
Position	0.044	.718**	1	.643**	-.614**	.614**	-0.251	-0.346	-0.330
Education	-0.045	.785**	.643**	1	-.723**	.723**	-0.329	-0.296	0.002
Provision	-0.044	-.629**	-.614**	-.723**	1	-1.000**	0.138	-0.097	-0.218
Age	0.044	.629**	.614**	.723**	-1.000**	1	-0.138	0.097	0.218
Section 1	-0.157	-0.126	-0.251	-0.329	0.138	-0.138	1	0.399	-0.264
Section 2	0.255	-0.202	-0.346	-0.296	-0.097	0.097	0.399	1	.494*
Section 3	0.409	0.033	-0.330	0.002	-0.218	0.218	-0.264	.494*	1

** Correlation is significant at the 0.01 level (2-tailed); * Correlation is significant at the 0.05 level (2-tailed).

3.5. Analysis of Variance

Table 6 presents the results of the Kruskal-Wallis test, a non-parametric test for independent samples. It is found that there is no statistical difference in auditor perceptions on the set of questions in each section when grouped according to gender, working experience, position, educational background, the experience of NAS provision, and age group. Hence, the fourth hypothesis is not supported. The results in this section confirm those of the previous test regarding the correlation coefficient analysis.

Table 6. Statistical Analysis for Various Groups

Section of Questions	Chi-Square	df	Asymp. Sig.
<u>Gender</u>			
Section 1	9.357	10	0.499
Section 2	9.930	10	0.477
Section 3	10.866	10	0.368
<u>Working Exp.</u>			
Section 1	0.551	2	0.759
Section 2	0.962	2	0.618

Section of Questions	Chi-Square	df	Asymp. Sig.
Section 3	2.594	2	2.730
<u>Position</u>			
Section 1	1.957	3	0.581
Section 2	3.647	3	0.302
Section 3	3.195	3	0.363
<u>Education</u>			
Section 1	2.121	2	0.346
Section 2	2.435	2	0.296
Section 3	0.254	2	0.881
<u>NAS Provision</u>			
Section 1	0.023	1	0.880
Section 2	0.433	1	0.511
Section 3	0.582	1	0.446
<u>Age Group</u>			
Section 1	0.023	1	0.880
Section 2	0.433	1	0.511
Section 3	0.582	1	0.446

4. Conclusions

This study examines auditors' perception on the impact of providing NAS to audit clients on auditor independence and audit quality. A questionnaire is adopted and distributed to external auditors in Indonesia. Seventeen respondents participated in the survey. Using non-parametric tests, it is found that auditors perceived the provision of NAS to somewhat impair auditor independence. In addition, based on their perception, auditors considered the provision of NAS to enhance the quality of the audit. It is also found that auditors disagree that the provision of NAS does not affect auditor independence. The correlation coefficient analysis and the test of variance both show that there is no significant difference in auditors' perception towards the set of questions in each section. This study is limited to a small number of respondents that work in public accounting firms in Indonesia; hence, it has low external validity. Future studies could broaden the sample to include accountants and financial managers to examine the perception from the side of auditees. Future research could also investigate whether auditor reputation has a significant difference on auditors' perception towards the provision of NAS, by comparing those that work in big-four and non-big-four public accounting firms.

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