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AN EMPIRICAL ANALYSIS ON THE INDEPENDENCE OF THE GREEK CERTIFIED AUDITOR-ACCOUNTANT

by

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ABSTRACT

The objective of this paper is to examine the perceived effects of the: (a) size of audit firm, (b) provision of management advisory services, (c) competition between audit firms and (d) auditor's tenure on the risk that independence of a certified auditor may become impaired. Factorial analysis of variance techniques are used to analyze judgments obtained from three subject groups in Greece: i) certified auditors, ii) bank executives in loan decisions and iii) financial analysts. The groups of certified auditors and financial analysts expressed the opinion that small audit firms when operate in highly competitive environment, provide management advisory services, as well as have tenure with a given client more than three years, perceived as having a higher risk of losing independence. The group of bank executives in loan decisions considered that high competition and the provision of management advisory services have an effect on the risk that the independence of a certified auditor might become impaired.

1. INTRODUCTION

The operation of the economy depends on the communication of financial data. In order for the users of financial statements to gain assurance that the data are being reported, properly measured and fairly presented, independent certified auditors audit financial statements and express an opinion on the fairness of these statements. The value of auditing services depends upon the fundamental assumption that the certified auditors are not influenced by their client-firms or by other financial bodies (governmental or non). The term audit independence refers to the ability of the certified auditor to act with integrity and impartiality during his/her auditing practice.

The academic research on accounting and auditing profession in Greece is still in its infancy. As far as auditing is concerned, Caramanis (1997 & 1998) examined the impact of introduction of competition in the market for statutory audits and the concomitant economic dependence of Greek auditors on audited companies. Ballas (1998) examined the emergence of the auditing profession in Greece and how it was used by the state to further its strategic interests during the late 1940s and early 1950s period.

The objective of this paper is to provide empirical evidence relevant to the perceptions of the certified auditor's independence. More specifically, the paper examines the effects of four factors: a) size[1] of audit firm (S), b) provision of management advisory services[2] (M), c) competition[3] between audit firms (C), and d) auditor's tenure[4] (T), with respect to the certified auditor’s independence.

NOTES

1. The criteria (isolated or/and combined) which were used to determine the size of the audit firm were: a) total assets more than 130.000.000Dr. (Euro 381.511) or b) net value for provision of services more than 260.000.000Dr. (Euro 763.023) or c) the mean of certified auditors of the specific audit firm more than 50 auditors or d) the conduct of audit controls in more than one firms admitted to the stock market.
2. The term management advisory services is defined as the provision of a series of services beyond the audit by the certified auditor to the company-client. These services have an advisory character and cover issues such as: a) the plan, installation and supervision of the

2. EXPERIMENTAL FACTORS

The factor size of audit firm arises from the legal obligation of the Greek certified auditors to establish auditing firms and the assignment of auditing by the company-client only to those firms. Usually, a large audit firm tends to be less dependent on a given company-client than a small one, because the associated fees in most of the cases constitute a smaller proportion of the audit firm's total revenues. On the other hand, a small audit firm may develop a more personal mode of service and close relationships with a company-client (Schulte 1965; Titard 1971; Hartley and Ross 1972; Shockley 1981; McKinley, Pany and Reckers 1985; Palmrose 1986).

The factor provision of management advisory services is examined because it is inconsistent with the auditing profession. A certified auditor providing both auditing and consulting services may become not only advocate of the client but also develop too close relationship with the management making difficult to remain independent. As a result he/she does not give appropriate emphasis and effort to perform the audit work necessary to support his/her opinion. Moreover, the audit firm may develop a stake in the company-client and its prestige as a successful adviser depends upon the client's success, placing therefore the audit firm in the position of auditing its own decisions (Goldman and Barlev 1974; Shockley 1981; Antle 1984; Pany and Reckers 1987; Barkess and Simnett 1994; Caramanis 1997).

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operation of accounting and cost accounting systems, budget and inventory systems, information technology systems related to accounting, b) counseling in investment issues, finance, management and business administration, corporate planning, internal control, and taxation.

[3]. The nature and the degree of competition among the audit firms is influenced by certain factors which are called 'powers of competition'. These 'powers' are the following: a) the potential entry of new audit firm into the market, b) the negotiating power of the audit firm and c) the negotiating power of company-client.

[4]. The term audit tenure is defined as the number of consequent years, during which a certified auditor has conducted the audit to his company-client.

The factor competition among audit firms is created from the weakness of the Greek legislator to define the minimum auditing fee as well as the auditing time that is necessary to complete the audit work. However, an audit firm which allows competition, and implicitly its fee, to affect the nature of its audit may also be dangerously close to be in a non independence condition. As competition for audit clients increases, clients' opportunities and incentives to replace incumbent auditors as well as increase. Reasons for that change may range from minimization of audit fees to a search for a more compliant certified auditor. Regardless, certified auditors' dependence on their company-clients may increase if they believe that other auditing firms in the same working area will accept the engagement when the company-client become displeased (Shockley 1981; DeAngelo 1981; Anderson and Zeghal 1994).

The factor auditor's tenure in years in the same company-client appears from the ambiguity of the Greek legislation on that issue. Long association between a company-client and an auditing firm may lead to a close identification of the auditing firm with the interests of its company-client's management and hence to be an obstacle to the free expression of the auditor's professional opinion. Complacency, lack of innovation, less rigorous audit procedures, and a learned confidence may arise after long association with the company-client (Lavin 1976 & 1977; Shockley 1981).

3. DATA AND METHODOLOGY

This research focuses only on the recording and interpretation of the viewpoints of the three relevant groups: a) the certified auditors, b) the bank executives in loan decisions, and c) the financial analysts.

The group of certified auditors consists of all the registered members of the Greek Auditing-Accounting Body (in Greek: Soma Orkoton Electon-Logiston, 'SOE-L'). The data are derived from the records kept in that body for the year 1997. Due to the fact that the population of the Greek certified auditors was arithmetically as well as geographically[5] restricted, we included in the research the total number of them. The survey instrument was mailed to all 315 certified auditors and 70 usable responses were received, a response rate of 23%. Respondents had an average age of approximately 55 years and had an average experience more than 20 years in auditing practice. All of them had earned a bachelor's degree, twenty-one percent of the respondents had a master's degree and four percent had a Ph.D. degree in the field of accounting.

The group of bank executives in loan decisions were randomly selected from the membership directory of the Greek Banking Association for the year 1997. The questionnaire was addressed to the head executive loan officers of both public and private bank institutions[6] who work in the geographic[7] area of Athens and Thessaloniki. Research questionnaires 180 were mailed and 45 fully complete usable responses were received, a response rate of 25%. Respondents had an average age of approximately 45 years and had an average experience in making bank loans of 10 years. Over 93.1% of the group had earned at least a bachelor's degree, 25.2% had a master's degree and 9.1% had a Ph.D. degree in accounting or auditing.

The group of financial analysts were derived from the data included in the economic guide (Department of Services-Financial and Investment Companies) of ICAP, year 1997. Due to the small number of financial analysts[8], we included the total number of the population. The questionnaire was addressed to the head financial analysts of the

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5. In September of 1997, the overwhelming majority of certified auditors, 304 individuals (96.5%) were active in Athens, 8 individuals (2.5%) were occupied in Thessaloniki and lastly, 3 individuals (1%) offered their services in Patra.

6. The bank institutions which were examined in this research are: a) Alpha S.A., b) Aspis S.A., c) General S.A., d) Citibank S.A., e) Crédit Lyonnais S.A., f) National Bank of Greece S.A., g) Commercial S.A., h) ETVA S.A., i) ETEVA S.A., j) European Popular S.A., k) Egnatia S.A., l) Ergo bank S.A., m) Euroinvestment S.A., n) Interbank S.A., o) Ionian S.A., p) Central Greece S.A., q) Cyprus S.A., r) Macedonia-Thrace S.A., s) Nova Scotia S.A., t) Natwest S.A., u) Peraios S.A., and v) Chios S.A.

7. This selection was made because the central services of the bank institutions operate in these cities and thus, the majority of highest rank personnel is concentrated there.

8. More specifically, during the investigation of this research (September of 1997), 59 financial firms were in operation, in which 106 financial representatives in total, were occupied.

investment departments of each financial company. Of the 106 financial analysts contacted through mailed questionnaire, 29 returned usable responses, a response rate of 27%. Respondents had an average age of approximately 40 years and had an average experience in their field of 7 years. All of them had earned a bachelor's degree, 69.7% had a master's degree and 12.1% a Ph.D. degree.

The combination of the four factors, each of which had two treatment levels[9], resulted in sixteen (16) independent questions, which were named 'scenario-questions'[10] followed by a numerical scale from one to five. The scale represented the risk that an auditor's independence may become impaired in the appearance of each 'scenario-question'. Number 1 was defined as 'very low risk' while number 5 was defined as 'very high risk'. To provide a higher level of realism, subjects were provided with a concise, narrative explanation of each independent factor.

The above construction of the questionnaire, succeeded in having the same number of answers in every possible combination among the levels of the four factors included in the research. Each subject was asked to rate each 'scenario-question' entirely on the basis of the four pieces of information provided therein. The same person answered simultaneously all sixteen (16) 'scenario-questions' and was encouraged to alter any response if he/she though so. This means that we have repeated measurements which

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[9]. Every factor examined was separated into two level: a) the size of the audit firm in: 'big' or 'small', b) the provision of management advisory services in: 'yes' or 'no', c) the competition between audit firms in: 'high' or 'low' and d) auditor's tenure in: 'more than three years' or 'less than three years'.

[10]. The following is indicative of the form of one 'scenario-question' which was included in the questionnaire:

"On the basis of the combination of the following factors:

Size of audit firm	:Big
Provision of management advisory services by the audit firm to the company-client	:No
Competition among audit firms	:High
Auditor's tenure in years in the same company-client	:<3ys

do you think they create danger of certified auditor's independence?

Please circle one of the following answers which you believe is suitable:

1	Very low	risk of the loss of certified auditor's independence
2	Low	risk of the loss of certified auditor's independence
3	Medium	risk of the loss of certified auditor's independence
4	High	risk of the loss of certified auditor's independence

are derived from the same person and are correlated. Analysis of the data was conducted at the overall level and within each subject group (certified auditors, bank executives in loan decisions, financial analysts).

4. RESULTS

In the overall level, the statistically significance interactions at the .01 level, between the grouping factor and the experimental factors of size and competition indicate differences between groups in the perceived significance of those two factors. An understanding of the nature of these interactions was obtained by analyzing each group’s responses separately, thereby eliminating the confounding effect of the grouping factor. Their analysis indicated that: first, the groups regard that smaller audit firms are more likely to lose certified auditor’s independence than larger audit firms, second, the subject groups consider that high levels of competition among audit firms increase the risk that certified auditor’s independence may be impaired. However, in both cases the different opinions expressed between the three groups of this research lie in the fact that the certified auditors’ opinions are stronger than those of the other two.

4.1 CERTIFIED AUDITORS

There are statistically significant interactions among the factors (Table 1): size and provision of management advisory services (p-value=0.0001), size and competition (p-value=0.0077) and size and tenure (p-value=0.0001). Insight into the nature of these interactions was provided by examination of the simple effects. The simple effects on the certified auditor’s independence indicated that: first, in both levels of the factor size the provision of management advisory services creates danger of certified auditor's independence ($p<0.01$). However, the group of certified auditors weighted provision of management advisory services much more heavily in small audit firms than did in big

5 Very high risk of the loss of certified auditor's independence".

ones. This difference may result because large audit firms afford special, qualified, separate staff for the management advisory services function are less likely to impair the independent certified auditor status, while in small firms such specialization is neither possible nor feasible. Second, in every level of factor size the competition between audit firms creates a risk of losing certified auditor's independence ($p<0.01$). The certified auditors weighted competition much more heavily in small audit firms than in big firms. This indicate that competition does, in fact, have a larger impact on partners in small audit firms. Moreover, the auditing profession is facing too much rather than too little competition among the audit firms for the control of clients in the area where they function and offer their services. Third, when the size of an audit firm is characterized as 'small' and certified auditor's tenure in the company-client is 'more than three years', creates danger of the loss of his independence ($p<0.01$). This means that certified auditors regard that the development of personal relationships can have an effect on their objectivity. Therefore, there is a particular need for a practice to ensure objectivity approach to any assignment, is not endangered as a consequence of any personal relationship.

4.2 BANK EXECUTIVES IN LOAN DECISIONS

There is statistical significant interaction between the provision of management advisory services and the competition (p-value=0.0084, Table 2). The analysis of their simple effects on certified auditor's independence indicated that a 'high' level of competition in the audit market and the provision of management advisory services by the certified auditor to the company-client, increases the apparent likelihood of a conflict being resolved in favor of the client. The amount of management advisory services provided to clients is a factor that bank executives in loan decisions consider in evaluating certified auditor's independence ($p<0.01$).

4.3 FINANCIAL ANALYSTS

There are statistically significant interactions among the factors (Table 3): size and provision of management advisory services (p-value=0.0017) and competition and tenure within the company-client (p-value=0.0016). In order to get a more accurate view of the nature of these interactions we examined the simple effects. Their analysis indicated that: first, when the size of the audit firm is ‘small’ the provision of management advisory services creates danger of loss of the certified auditor's independence ($p<0.01$), second, when the tenure is ‘more than three years’ the high competition among the audit firms creates danger of loss of certified auditor’s independence ($p<0.01$).

5. CONCLUSIONS

We examined the perceptions of certified auditors, bank executives in loan decisions and financial analysts with respect to the independence of the Greek certified auditor. The subjects considered the impact of four variables on the risk that the independence of a certified auditor might become impaired. We may conclude that:

i) The groups of certified auditors and financial analysts, expressed the opinion that when the audit firms appointed to be of small size, run a higher risk of losing certified auditors' independence than the big size audit firms. The protection of the certified auditor's independence presupposes that the audit firms function exclusively under a specific legal form (i.e., Limited Company or Societe Anonyme). In such a case, they are forced to publish their financial statements, and their financial data have to undergo, if this is stipulated by the Greek Law 2190/20, the control from external certified auditors. Moreover, there is a need to set the lowest limit of the share capital, which is essential for the establishment and operation of an audit firm, as well as to legally foresee its payment during the firm's establishment.

Furthermore, they believed that the provision of the management advisory services by the certified auditor to the company-client increases the danger of the certified auditor's loss of independence. The Greek legislative framework does not clarify the above issue. However, the Greek Auditing-Accounting Supervisory Board, adopts specific rules and principles from other internationally acknowledged professional institutions such as I.C.A.E.W., I.C.A.S., I.C.A.I., which have dealt with the above issue.

In addition, the profession should continue to emphasize to its certified auditors the importance of objectivity evaluating engagements involving provision of management advisory services from the perspective of appearance as well as fact. Moreover, there is a need to specify the cases under which the provision of management and advisory services or/and the existence of economic concern by the certified auditor for the course of firm's business, creates dangers at the expense of his independence and his impartiality.

ii) The groups of certified auditors and bank executives in loan decisions, considered that the competition between audit firms is related with the potentiality of certified auditors, to negotiate the level of audit fee, as well as the volume of audit business which one auditor is allowed to undertake and follow.

Regarding the level of audit fee, the Greek Auditing-Accounting Supervisory Board is responsible for determining the audit fee. As far as the volume of audit business, the current legislation determines the limits of the auditor's annual employment. However, the increased potential for damage to the profession’s credibility justifies careful consideration of any policy designed to insulate the certified auditors from inappropriate influence by management.

iii) The group of financial analysts expressed the opinion that the significance of tenure implies that any policy action taken to reduce the average tenure of certified auditors may have a positive effect on perceptions of their independence. The current legislation foresees that the assignment of the regular control of an economic unit by a specific certified auditor can not be repeated for more than five consecutive or interrupted years. However, it is possible that carefully selected alternative policy steps (stricter in-house review procedures for auditing firms, rotation of certified auditors between companies-clients) taken from Greek Auditing-Accounting Supervisory Board could have the same positive effect as legislation.

In conclusion, this study indicates that each factor examined has an effect on the certified auditor's professional independence and the importance of this influence will increase, as the capital market grows and there is a constant need to supply reliable information.

APPENDIX

TABLE 1

Repeated Measures Analysis of Variance for
Certified Auditors

	SS	df	MS	F	Pr(F)
Main Effects:					
S	128.25	1	128.25	46.41	0.0001*
M	35.35	1	35.35	27.62	0.0001*
C	120.25	1	120.25	52.96	0.0001*
T	1.22	1	1.22	1.59	0.2112
Interactions:					
SxM	5.57	1	5.57	17.39	0.0001*
SxC	2.90	1	2.90	7.54	0.0077*
SxT	8.40	1	8.40	24.37	0.0001*
MxC	0.001	1	0.001	0.00	0.9576
MxT	0.008	1	0.008	0.02	0.8930
CxT	0.20	1	0.20	0.43	0.5125
* = less than p<0.05					

TABLE 2

Repeated Measures Analysis of Variance for
Bank Executives in loan decisions

	SS	df	MS	F	Pr(F)
Main Effects:					
S	15.66	1	15.66	6.11	0.0175
M	12.82	1	12.82	3.80	0.0578

C	27.44	1	27.44	10.8	0.0020*
T	0.62	1	0.62	0.44	0.5127
Interactions:					
SxM	0.04	1	0.04	0.07	0.7964
SxC	1.36	1	1.36	2.79	0.1024
SxT	0.07	1	0.07	0.13	0.7208
MxC	2.62	1	2.62	7.63	0.0084*
MxT	0.07	1	0.07	0.19	0.6638
CxT	0.41	1	0.41	1.01	0.3212
* = less than p<0.05					

TABLE 3

Repeated Measures Analysis of Variance for Financial Analysts

	SS	**df**	**MS**	**F**	**Pr(F)**
Main Effects:					
S	22.91	1	22.91	21.05	0.0001*
M	17.45	1	17.45	13.78	0.0008*
C	8.25	1	8.25	4.67	0.0382
T	9.81	1	9.81	7.40	0.0104*
Interactions:					
SxM	8.75	1	8.75	11.68	0.0017*
SxC	0.07	1	0.07	0.14	0.7094
SxT	0.12	1	0.12	0.46	0.5012
MxC	0.12	1	0.12	0.23	0.6324
MxT	2.18	1	2.18	3.41	0.0742
CxT	10.93	1	10.93	11.84	0.0016*
* = less than p<0.05					

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