Auditors Independence and Non Audit Services Impact on Audit Expectation Gap in UAE Banking and Financial Sector

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Abstract: Audit Expectation Gap is the vacuum between society and general public demands from Auditing profession and Auditors actual performance. This vacuity is caused due to several factors and two such causes i.e Independence of Auditors and Non Audit Services of auditors is the focus of this paper. This study is aimed at UAE Banking and Financial Sector. The study helps to understand the Audit Expectation Gap existence, impact of Independence and Non Audit Services of Auditors. This paper also explores for measures to eliminate or narrow the gap.

Keywords: Audit Expectation Gap, Auditors Independence, Non Audit Services, Auditors

I. Introduction
This study aims to provide solutions to the rise in the audit expectation gaps due to the auditors Independence and Non Audit Services.

Alternate Hypotheses
• There is an expectation gap between auditor and user (bankers and investors) in relation to the performance of the audit responsibilities with auditor’s independence.
• There is an expectation gap between auditor and user (bankers and investors) in relation to the non-audit services provided by the auditor.

II. Auditing Expectation Gap
Auditing function is essential in any economy as it helps business / firms to confirm their state of affairs. The professional verification and evaluation of financial reports adds credibility to the financial statements. This information in turn enables smooth functioning of capital markets. Auditing function enables companies to have increased accountability towards society and chances of errors can be minimized. Audit Expectation Gap is “the difference between the levels of expected performance as interpreted by the independent accountant and the user of financial statements” (Liggio, 1974) [1]. “The expectation gap is an issue for auditors because a greater expectation gap would lead to lower credibility, earning potential and prestige associated with their work. It is also an issue for the public and investors in particular because the wealth creation and stability of an economy depends upon confidence and accountability provided through the external audit” (Sikka, 2003) [2].

1.1. Auditors Independence
Independence is the foundation for auditing profession. Auditors who are independent can report objectively regarding the financial statements of their client. The stake holders look forward to the auditing report for auditors add value to their financial decisions. Independence of auditors is much debated as it often becomes a mystery especially when firms get a clean chit from auditors just before the firms / clients are identified in huge financial scandals and corruptions. Investors and shareholders often get shocked to see audited financial statements quickly turn up famous for scandals, frauds and corruptions.

Rabinowitz (1996) [3] studied the expansion of auditors’ responsibility and Independence and observed few deficiencies in the audit process which have decreased public confidence in the profession. His suggestions where to improve internal external audit interaction along with effective audit procedures and practices. Ojo Marianne (2009) [4], considered factors which threaten auditor’s independence in banking regulation and supervision. Mahdi Salehi (2009) [5], discussed about auditor independence and audit expectation gap between auditors and investors and revealed significant expectation gap between auditors and investors on actual level of independence in Iran. Ogbonna and Appah (2014) [6] examined the audit expectation gap and firms performance in Nigeria. Cross sectional field survey of the quasi experimental research design was used for the study and highlighted various factors contributing to the expectation gap.

1.2. Non Audit Services (NAS)
Non audit services are the services by auditing firms / auditors to their clients. It may include tax services, advisory services, and consultancy services etc. There are many arguments in favor and against of...
Auditors providing Non audit Services to the companies they audit. Non Audit services impact the auditors Independence. Hence it is a complex issue to decide what extent of NAS are to be allowed and how to have an effective regulation on NAS by auditors to their clients.

In New Zealand, Cameron (1993)[7] study revealed that third parties want auditors to give to some extent compliances services, accounting services and general advice and actively help in sorting client’s problems and advice on client’s financial health. In China, Lin and Chen (2004) [8] study investigated opinions of shareholders regarding the effects on independence when non audit services were provided by auditors to their clients and revealed expectation gap with respect to audit objectives, auditors’ obligation to detect and report fraud, auditor independence and third party liability of auditors. Mahdi Salehi (2009) [9] study results confirmed that practicing non audit services by external auditors to the same client has negative impact on auditors’ independence and also confirmed that shareholders believed that non audit services impair audit independence.

Ojo, Marianne, (2013) [10], “Sarbanes Oxley, non-audit services and the Mandatory Rotation of Audit Firms (Paper presented at the 2014 ICHEG Conference, Abu Dhabi (UAE) March 19-20 2014, Published in the International Conference Proceedings of PSRC)” study considered the dual roles of external auditors when acting in a dual capacity of internal and external auditor does affect objectivity and independence in exercising their functions. The focus was also placed on external auditor view point who perform internal audit function. This paper revealed that non audit services prohibition does not imply that conflicts of interest will be reduced. The study also revealed that though non audit services comprise auditors’ independence but certain benefits are also obtained due to the dual roles capacity. The study identified that in several places the focus is on traditional auditing techniques. David Hay (2015) [11]in his paper ‘The frontiers of Auditing Research’ discussed the current issues and fundamental issues in Auditing and suggested auditing reforms to improve independence and competence of auditors.

III. Research Methodology

The focus of the study is limited to two UAE emirates (Dubai and Sharjah). The sample includes participants from the UAE Banking and Financial Sector: auditors and user’s i.e bankers and investors (include other parties like auditees, managers, accountants, directors, internal auditors, audit beneficiaries, from inside and outside the financial community). The responses are analyzed to identify differences of opinions between the groups in UAE Banking & Financial Sector. The sample size is 260. Kruskal Wallis test is used to find the gap between all the 3 major groups (Auditor vs Banker vs Investor). This test is largely used to find out whether three or more group’s mean ranks are equal or not. Almost all the three groups of people have equally participated in the study. Among auditors, 24 of them have accounting qualification, 6 respondents have accounting experience, and 86 respondents have auditing qualification and experience. Among bankers, 46 have accounting qualification, 13 respondents have accounting experience, 3 bankers have auditing qualification and 2 have auditing experience. Amongst investors, 58 of them have accounting qualification, 40 respondents have accounting experience, 4 investors have auditing qualification and 7 have auditing experience.

3.1. Auditors Indepency

**HO**: There is no expectation gap between auditor and user in relation to the performance of the audit responsibilities with auditor’s independence.

**HA**: There is an expectation gap between auditor and user in relation to the performance of the audit responsibilities with auditor’s independence

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<th>Table 1 Hypotheses – Auditors Indepency</th>
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<td>Auditors</td>
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<td>1. Economic dependency on the client, has a negative effect on independence</td>
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<td>2. Prospects of reappointment can impair audit independence</td>
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<td>3. Non Audit services weaken independence</td>
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<td>4. Independence enables him to adhere to professional ethics.</td>
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Considering the first statement, expectation gap reveals that the auditors mean is significantly lower than the results obtained from bankers and investors group (2.33 Vs 3.77 & 3.95, p<0.01). This result indicates that auditor’s dis-agreed that their economic dependency on the client has a negative effect on Independence. The second statement, expectation gap reveals that the auditors mean is significantly lower than the results obtained from bankers and investors group (2.30 Vs 3.87 & 3.91, p<0.01). This result indicates that auditors do not believe that their economic dependency on the client has a negative effect on independence. With the third statement, expectation gap reveals that the auditors mean is significantly lower than the results obtained from bankers and investors group (2.28 Vs 3.76 & 3.93, p<0.01). This result indicates that auditors do not believe that their economic dependency on the client has a negative effect on independence. The fourth statement agreed by all parties shows the extent of Audit Expectation Gap and the desperate need to resolve the gap.

To conclude hypotheses, evidences point out to reject the null hypotheses.

### 3.2. Non Audit Services by Auditor

**HO**

There is no expectation gap between auditor and user in relation to the non-audit services provided by the auditor.

**HA**

There is an expectation gap between auditor and user in relation to the non-audit services provided by the auditor.

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<th>Table 2 Hypotheses – Non Audit Services by Auditor</th>
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*Average scores based on a 5-point Likert scale
Significant levels indicated as follows: Users Vs Auditors significant at p ≤ 0.10

Considering the first statement, expectation gap reveals that the auditors mean is significantly lower than the results obtained from bankers and investors group (2.31 Vs 3.89 & 3.93, p<0.01). This result indicates that auditors do not believe that NAS affect objectivity of auditor. But bankers and investors believe that the NAS affect the objectivity of auditor. Considering the second statement, expectation gap reveals that the auditors mean is significantly lower than the results obtained from bankers and investors group (2.30 Vs 3.87 & 3.94, p<0.01). This result indicates that auditors do not believe that Non Audit services attract conflict of interests of an auditor. The third statement, expectation gap reveals that the auditors mean is significantly lower than the results obtained from bankers and investors group (2.26 Vs 3.62 & 3.88, p<0.01). This result indicates that auditors do not believe that Non Audit services should be avoided by an auditor. Lastly, the fourth statement, expectation gap reveals that the auditors mean is significantly lower than the results obtained from bankers and investors group (2.26 Vs 3.72 & 3.87, p<0.01). This result indicates that auditors do not believe that Non Audit services have a negative influence on the audit report.

To conclude hypotheses, evidences point out to reject the null hypotheses.

### IV. Conclusion

Auditors need to avoid anything that decrease the public trust on auditing profession and financial statements. Hence, Non Audit Services should be fully disclosed to shareholders. Auditor’s disclosure is vital, especially in those cases where the Non Audit Services are charged more than audit services. All Non Audit Services should be pre-approved by auditing boards and committees. Non Audit Services should not compromise auditor’s independence and should be within the regulatory and ethical framework. Auditors should voluntarily suspend all those Non Audit Services which interfere with auditor’s independence, objectivity and...
integrity. Non Audit Services cannot be totally prohibited as they are provided by auditors who can also have greater exposure of the auditing company. Therefore Non Audit Services can be used for improving the audit quality and the benefits can be obtained without giving up the auditors Independence. Certain services should be prohibited as they may impact independence.

Society and general public demands are often viewed by auditors as unreasonable demands and auditor’s performance is viewed by society as below the standard performance. The question whose expectations are correct? Can never be answered as they are changing with change in expectations. Solution can be addressed by all the groups as existence of gap is not beneficial to anyone. Further widening of this gap harms auditing profession as it will lose its confidence in the eyes of public. Thus to conclude, elimination of the Auditing Expectation Gap may be impossible but narrowing of the gap is the need of hour.

References