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# **Non-Audit Fees and Auditor Independence: Nigerian Evidence**

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# **Non-Audit Fees and Auditor Independence: Nigerian Evidence**

## **ABSTRACT**

*Purpose of this paper:* This study aims to investigate the extent to which the provision of Non-Audit Services (NAS) by external auditors to audit clients affects auditors' independence and the audit expectation gap in Nigeria.

*Design/methodology/approach:* The study adopts an interpretivist approach. Thirty semi-structured, face-to-face interviews were conducted to explore the views expressed by audit partners and pension fund managers in Nigeria; group responses were evaluated and presented separately. After transcribing the interview audio recordings, a thematic data analysis of the two groups' responses was performed.

*Findings:* Interpretation of the interview responses indicates that the provision of NAS by audit firms to their audit clients is regarded by auditors as a matter of economic necessity. Nevertheless, it is also perceived as impeding auditors' independence and increasing the gap between the auditor and public expectations.

*Practical implications:* This study contributes to the debate surrounding the need for an independent body to oversee auditing standard setting distinct from the current practice to enhance transparency.

*The original/value of the paper:* A qualitative analysis of the nuanced responses obtained from the semi-structured interviews reveals starkly the perceived economic pressures on auditors to accept non-audit work. Moreover, it endorses the regulation to restrict non-audit work in support of a sustainable fee level for independent audit.

**Key words:** Auditor independence, Non-audit services, Expectation gap, Public confidence, Nigeria.

**JEL Classification:** M42

## 1. INTRODUCTION

The contribution of regulation to audit quality through measures to promote auditor independence is the subject of ongoing debate in Nigeria and elsewhere, with some evident criticism of auditors (Akinbuli, 2010; Atu and Atu, 2010; Ilaboya and Ohiokha, 2014). Legislation in the USA has prevented auditors from providing nine specified non-audit services to audit clients, while requiring audit committee prospective authorisation for others (H.R. 3763, 2002). However, despite consideration, restrictions on the provision of non-audit services by European auditors (European Commission (EC), 2002) were not implemented. Standards for Nigerian auditors remain based on principle and are relatively permissive. Currently, the issue for investors, companies, auditors and regulators concerns whether further regulation should be placed on Nigerian auditors' activities in the pursuit of narrowing the expectation gap; specifically, the deficient standards gap after Porter (1993).

Given that independence is a "state of mind" (ICAN, 2009), the authors of this paper believe an in-depth qualitative evaluation of auditors' and shareholders' reported perceptions contributes valuable evidence, unavailable elsewhere, to the debate.

Quantitative studies have taken the occurrence of non-audit fees with the presence of discretionary accruals as a proxy for compromised auditor independence. The results of these studies are inconsistent (Tepalagul and Lin, 2015). Despite adopting a qualitative approach, this study contributes to the debate contained in the literature. Perceptions of auditor independence in Nigeria have been surveyed previously to identify the most significant perceived threats to independence (Adeyemi and Akinniyi, 2011; Adeyemi and Oloowokere, 2012), elements of the audit expectation gap (Oloowokere and Soyemi, 2013; Onulaka, 2015), influence of non-audit fees on independence (Akinbowale and Babatunde, 2017), and the advantages and disadvantages of appointing joint auditors (Okaro et al, 2018). Such studies have attained international significance given the rapid development of the Nigerian economy, with a tenfold increase in GDP between 1997 and 2017 to rank thirtieth largest in the world (World Bank, 2018) and the nation's role as the fourteenth largest producer of crude oil (Fantini and Quinn, 2017).

This study contributes a further investigation specifically in relation to perceptions of the effect of non-audit fees on auditor independence. Where previous studies have analysed perceptions quantitatively using response scales, this study takes a more qualitative approach by thematically analysing interview responses. This study responds to Power and Gendron's (2015) promotion of "multi-culturalism" of methods in audit research. The free form of

responses directs this study further towards the subjective part of the spectrum of approaches to social sciences contextualised to auditing by Dirsmith et al (2010) after Morgan and Smircich (1980). Through openness to issues that can be raised through this novel approach, the authors believe new ideas can and have been discovered; thereby contributing to the debate on regulation.

The remainder of the paper is structured as follows. Section 2 presents a literature review in which studies relevant to the topic in Nigeria and worldwide are addressed over three subsections, with the final subsection used to state the study objective. Section 3 details the research method. Section 4 presents the analysis and, finally, Section 5 presents the conclusions of the research.

## 2. LITERATURE REVIEW

### 2.1 *Independence*

Independence was said by Flint (1988) to be “probably the most important of the audit postulates”. The Institute of Chartered Accountants of Nigeria (ICAN) confirms that auditor integrity requires independence, intellectual honesty, freedom from conflict of interest and an objective approach to the audit process (ICAN, 2009). In line with these assertions, the Nigerian Standards on Auditing (ICAN, 2013) states: “The engagement partners shall form a conclusion on compliance with independence requirements that apply to the audit engagement.” The Professional Code of Conduct and Guide to Members (ICAN, 2009) elaborates on two aspects of independence:

“Independence of Mind”, defined as “the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.”

“Independence in Appearance”, defined as “the avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm’s, or a member of the assurance team’s, integrity, objectivity or professional skepticism had been compromised” (ICAN, 2009).

Adeyemi and Akinniyi (2011) conducted a cross-sectional survey of the perceptions of 100 Nigerian lecturers, auditors, stockbrokers, shareholders and managers of listed companies. In this study, the size of audit fees was concluded to be perceived as having the most significant effect on an auditor’s independence. In Adeyemi and Oloowokere’s (2012) study, of 142 survey responses gathered from Lagos state investors, 66.9% agreed that auditors should not by law be allowed to provide non-audit services to audit clients, while 78.2% concurred that those providing such services could not maintain their independence. Adeyemi and Oloowokere (2012) established the most common perception of the main threat to auditors’ independence was self-interest, with 30.1% of responses. However, the majority (69.9%) of respondents chose some other factor as the main threat to independence; namely, self-review, advocacy, familiarity to trust or intimidation. Oloowokere and Soyemi (2013) surveyed the perceptions of 263 auditors, bankers and investors based on the extent of their agreement or disagreement with statements on auditors’ responsibilities, one of which addressed auditor bias and objectivity. These works share an approach that records and analyses respondents’ views

without investigating their reasons for holding them. To obtain an overall view from studies that consider specifically the effect of non-audit fees on auditor independence, it is necessary to look beyond recent Nigerian literature.

## *2.2 Non-audit services*

Quantitative studies identifying signs of lack of auditor independence reveal inconsistent results. Frankel et al (2002) examined 3,074 proxy statements filed with the US SEC during 2001. They concluded the existence of a positive relationship between non-audit fees and earnings management; whereby, the latter is taken as being the magnitude of discretionary accruals combined with small variations in performance from analyst forecasts. However, Ashbaugh et al (2003) reperformed a similar analysis on 3,170 firms proxy statements and found no statistically significant association to confirm the results reached by Frankel et al.

In their experimental research, Joe and Vandervelde (2007) found that the provision of non-audit services was associated with a lower assessment of risk of misstatements than where only audit was performed. However, the same study also found that an external auditor using the same staff to offer audit and non-audit services may provide benefits to the client in the form of the transfer of knowledge between non-audit and audit activity.

In a Norwegian study conducted by Zhang et al (2016) on non-audit services and auditor independence, no relationship was found between non-audit services and auditors' independence.

Tepalagul and Lin's (2015) literature review notes the lack of consistent empirical evidence to demonstrate non-audit services impair auditor independence. Indeed, the evidence suggests that offering tax-related non-audit services enhances audit quality. Nevertheless, there is evidence of a widely-held perception that auditors' independence is hindered by offering non-audit services.

When Brandon et al (2004) reviewed 333 corporate bond ratings against non-audit fees, they found a significant negative relationship. This finding indicated that bond raters believed that auditors' independence was impaired through non-audit fees; thereby increasing the risk. In the Saudi Arabian context, Haniffa and Hudaib (2007) argued that book-keeping, tax and management advisory services were all found to be offered as ancillary services to audit clients despite professional pronouncements that they posed a threat to independence. Based on their

findings, some users of financial reports in Saudi Arabia believed that the provision of non-audit services can lead to the impairment of auditor's independence.

Such perceptions are significant as they may influence the actions of regulators. Thus, according to Edelman and Nicholson (2011), the publicly-documented failings of Arthur Andersen auditors influenced the subsequent Sarbanes-Oxley Act of 2002. This piece of legislation made it unlawful in the USA for a registered public accounting firm to provide a range of non-audit services to an audit client. Ghosh and Pawlewicz (2009) compared audit fees before and after the passing of the Sarbanes-Oxley Act and identified an increase in audit fees, both from increased audit work required of the auditor and the cost associated with assuming liability for discharging greater responsibilities.

Salehi et al (2009) surveyed 441 Iranian investors and Chartered Accountants. They found that while, in general, investors perceived greater threats to audit independence than auditors, there was no significant difference observed in the perceived threat presented by non-audit services. In a Nigerian survey of staff perceptions in the Ondo State Auditor General's Office, respondents gave divided opinions on their agreement or disagreement with statements that auditor independence was compromised by non-audit fees. However, they predominantly agreed that an auditor's access to information and knowledge of the client was enhanced by non-audit work (Akinbowale and Babatunde, 2017).

### *2.3 Audit expectation gap*

Porter (1993) attributes the phrase "audit expectation gap" (AEG) to Liggio, (1974). The term is defined as the difference between levels of expected performance "envisioned by the independent accountant and by the user of financial statements". From the evidence gathered from a New Zealand-based survey, Porter broadened the scope of the expectation gap to recognise the diversity in the expected performance levels of auditors and the actual achievements; in other words, to recognise a perceived "sub-standard" performance. This results in three divisions of the expectation gap for Porter: a "reasonableness gap" between what society expects from auditors and what could reasonably be delivered; and a "performance gap" between what could reasonably be delivered and what is perceived as being delivered. The performance gap is subdivided into "deficient standards" and "deficient performance". Deficient standards represent a gap where regulations fail to require the expected performance. Deficient performance represents a gap where perceived performance



fails to meet that level required by the regulations. Porter's overall result was that 34% of the gap was caused by unrealistic expectations, 50% by perceived deficiencies in standards, and 16% by perceived deficient performance.

Porter's classification across the three elements of the expectation gap included a requirement for respondents to evaluate, for several activities, what they considered the existing duties of auditors and noted that some of both non-auditors and auditors made inaccurate statements. In Olowookere and Soyemi's (2013) Nigerian study, 69% of respondents agreed or strongly agreed the auditor is responsible for producing the financial statements. Recognising these presuppositions about an auditor's role is important as it will influence the views individuals form about the extent of auditors' independence.

Onulaka's (2015) survey identified self-regulation and inadequacy in company law as part of the deficient standard gap in Nigeria.

In an empirical study of the existence of an audit expectation gap in Mauritius, Ramlugun (2014) found that the audit profession is currently under the spotlight given the number of financial scandals that have been uncovered globally. He further argued that these scandals not only have depressing consequences on business but also shake public confidence in the role of auditors.

From a Nigerian perspective, Ekwueme (2000) and Okike (2004) observe the auditing profession has been facing a crisis of credibility. This can be attributed to the criticisms levelled against auditors for failing to meet society's expectations following financial scandals in some of the large financial institutions with a high-profile rural network. For example, the rise in public expectation followed by the financial scandals and corporate collapse between 1998 and 2007 has fueled the erosion of public confidence in the audit process in Nigeria (Ekwueme, 2000). Examples in the financial service industry include the Intercontinental Bank Plc and Oceanic Bank Plc. The collapse of these banks shocked investors, potential investors, employees, creditors, and financial analysts (Ogundele et al, 2016). Atu and Atu (2010) in Nigeria found that the collapse of some banks and other companies arose from the financial scandal associated with unauthorised securities trading and falsified financial reporting, which placed the auditors in a poor light. Similarly, Akinbuli (2010) noted that the audit expectation gap undermined public confidence in the profession to detect and prevent corporate abuses and has made shareholders and the general public express their bitterness towards auditors in Nigeria.

## *2.4 Objective of the study*

Based on the studies discussed in Sections 2.1 to 2.3, the broad objective of this study is to explore the reported rationale behind perceptions of the influence of provision of non-audit services to audit clients on auditors' independence and the audit expectation gap, using a broadly interpretative approach.

The reported perceptions of audit partners and fund managers respectively are subjected to a thematic analysis to shed light on the participants' views and the reasons behind them.

Given a suitably critical interpretation by the reader, reported perceptions of auditors may contribute to an understanding of auditors' "independence of mind", while the responses of both auditors and pension fund managers may contribute evidence on which to base reasonable conclusions about "independence in appearance".

## **3. RESEARCH METHOD**

This study adopted a qualitative research approach using thematic analysis developed in Onulaka and Samy (2017). This method was selected to facilitate a holistic view of the issue under investigation to develop, free from the strict imposition of an a priori determination or categorisation of responses (Cassell and Symon, 2004). This qualitative investigation tends towards constructivism as described and advocated by Power and Gendron (2015), who caution that according to Latour (2005) only "risky texts" can result, which remain open to challenge with alternative interpretations.

As in Onulaka and Samy (2017), participants were either senior members of audit firms with post-qualification experience of 10 to 25 years, or Pension Fund Administrators (PFA) in the capacity of Investment Managers or Portfolio Managers with post-qualification experience of 10 to 22 years. Participating auditors were responsible directly or indirectly for several audit clients or a related function. Participating Pension Fund Administrators are currently active in the capital market with close links to Fund Custodians and the National Pension Commission.

Auditors are the suppliers of external audit services to their client companies. Given independence is viewed from one perspective as "a state of mind", it is not directly observable. Thus, it is necessary to enquire from auditors what their state of mind is and the associated influential factors. The use of Audit Partners to represent auditors is justified as they are the key players in auditing industries.

Companies are the consumers of external auditors' services, but are unable to speak for themselves, other than through directors or shareholders. This study considers shareholders, rather than directors, to be the preferred proxy for the company whose interest the auditors serve. Their perceptions are also investigated by this study and present a balance to the auditors' views, as auditors and shareholders may be regarded as having differing, if overlapping, interests in a company's audit. The use of Pension Fund Managers to represent investors is justified by virtue of Section 73 (1) of the Nigerian Pension Reform Act 2004. As noted in the annual abstract of the Nigerian Federal Office of Statistics for 2015, more than 500 billion Naira worth of pension fund investment portfolios were being traded on the Nigerian Stock Exchange.

All organisations from which participants were drawn for this study were from the private sector. Of the respondents, 10 were chosen from each of the country's three major regions; namely, the North, East and Western regions of Nigeria. The interviews were conducted in Abuja in the North, Enugu and Awka in the East, and Lagos in the West. Abuja, Enugu and Lagos were selected because they are the largest commercial centres of each of the chosen regions for this study, with some of the Eastern region respondents being interviewed in Awka while they attended a professional conference. The high level of commercial activity also attracts Chartered Accountants and audit firms to these areas.

A semi-structured, face-to-face interview was undertaken. The sample size of 30 participants (i.e. 15 interviews for auditors and 15 for fund managers) was considered suitable for this study as the emphasis was on depth rather than breadth, and to become saturated with information on the topic (Braun and Clarke 2006; Bordens and Abbott, 2014). Once 10 to 12 participants from each of the two major groups in the study had been interviewed separately, the responses of the remaining participants were almost determined and a saturation point was reached. Experimental findings of Guest et al (2006) indicate saturation occurring within the first 12 interviews, with metathemes apparent from as early as the sixth interview. All 30 participants are Chartered Accountants with a significant wealth of practical experience.

### *3.1 Reliability of the data and analysis*

The authors recognise the possibility of challenging the use of an auditor's reported perceptions to evaluate a respondent's independence. Furthermore, the responses of Pension Fund Administrators regarding others' independence might be interpreted as giving a platform to a biased view.

The responses of auditors and pension fund managers are summarised separately, with discussion of the responses identifying to which group the respondents belong. Thus, any bias that reflects the interests of the respondents in their roles as auditors or pension fund managers is prevented from distorting the overall results.

Reported perceptions do not provide proof of the respondents' actual perceptions, nor of the extent to which those perceptions are well informed. Nevertheless, the authors believe valuable evidence may be gained from reported perceptions, especially when there is a large degree of consistency within or across the two groups of respondents.

The anonymity and confidentiality of the respondents was ensured so they were able to provide information strictly for the purpose of this study. Where possible, some of the participants were interviewed twice following the unearthing of new information post-interview (Horton et al, 2004). Draft transcripts and analysis of the interviews were sent to participants for validation, and confirmation of correctness requested, as most of the responses were received by telephone. Data collections were made at different points across the three specified regions, and from more than one set of individuals at different times.

Auditor participants were contacted through the Directory of Members in Practice using the Year Books of the Association of Chartered Certified Accountants and the Institute of Chartered Accountants of Nigeria (ICAN). Auditors represented a range of large, medium and small-sized audit practices, with approximately half of the respondents representing small practices. Coverage across all geographical regions was obtained for each category of respondent, as presented in Table 1.

**Table 1 here**

Small and medium-sized audit practices were those whose clients are mostly small and medium-sized enterprises (SMEs), and who made use of external resources to cover limited in-house technical resources. For Nigeria, small entities are those whose staff numbers range between 1 and 10, and whose assets range between 1 million and 5 million Naira, while medium enterprises range between 10 to 50 members of staff and total assets spanning 5 million and 250 million Naira.

Pension Fund Administrator participants were identified from the Directory of Pension Fund Administrators in Nigeria (DPFA) regularly published in the website of the Association of Fund Managers of Nigeria and, in most cases, by asking earlier interviewees to suggest names

of those they would recommend to speak with the authorities on the issues or who held views they opposed (Horton et al, 2004). Thus snowball sampling was used in this investigation, which Groenewald (2006) states is a method of expanding the sample by asking one informant or participant to recommend others for further interviews. In locating the interviewees who have had experiences related to the study phenomenon, the researchers used the internet search engine. This also created a platform for sending e-mails and making follow-up telephone calls to participants in the audit firms and Pension Fund Administrators in Lagos, Abuja, Awka and Enugu.

#### **4. DATA ANALYSIS**

Thematic analysis is a method used by the authors because it is not wedded into a pre-existing framework; therefore, it is theoretically flexible (Braun and Clarke, 2006). Previous studies have tended to measure perceptions based on a Likert-type scale of agreement or disagreement with a set phrase determined by the researchers. The technique used in this analysis is drawn from the interpretivist tradition, as referenced below, to allow the emergence of themes from the respondents' comments. Such emergent themes, which have not been predetermined by the researchers, may provide novel insights. Therefore, the method used to identify the relevant themes in this study is conventional and appropriate to the study phenomenon (Tesch, 1990; Turnnidge et al, 2012). The following steps were adopted in developing the themes and subthemes:

- With the permission of the interviewees, each interview was audio-recorded and labeled with an assigned code (Groenewald, (2006); Bowen, (2005); Fink, (2000) and Ogiri, (2012)).
- The recorded data were transcribed and read repeatedly to enable the authors to become familiar with the datasets (Ryan and Bernard, 2003).
- The transcripts were read and re-read. Therefore, through familiarisation with the datasets, the authors could establish patterns and relationships in the various interview transcripts, and initial codes were generated (Sandelowski, 1995 p. 373).

- As repetition is one of the easiest ways to identify themes, some of the most obvious in the corpus of data were recurring topics or phrases across the interview transcripts (Bogdan and Taylor, 1975). From the in-depth interviews on a range of audit issues, it became apparent that the participants referred repeatedly to common ideas. In line with Strauss (1992) and Braun and Clarke (2006), it was concluded that these ideas were important themes in the phenomena under investigation. The authors discovered the relationships among these ideas by writing the concepts on a piece of paper and connecting them with lines to the verbatim expressions and quotes in the transcripts. In accordance with Weller and Romney (1988) and after Clarke and Spence (2013), the data was sorted after identifying the quotes or expressions and categorised as deemed relevant.
- The final step in the data collection process was to name the themes after which the results were summarised and presented in quote form in a table.

#### *4.1 Data Coding*

Interview transcripts were subjected to both open and hierarchical coding on issues pertaining to the interviewee's perception of the effect of the provision of non-audit services on auditors' independence in Nigeria and the audit expectation gap. The interview coding was guided by a list of predefined issues, themes, and categories, which were developed by the authors after the interviews had been conducted and transcribed.

The authors applied a systematic, line-by-line coding as a control measure to focus on the content of the text in the lines, which helps us concentrate on the research topic. Subsequently, descriptive codes were produced and analytic codes developed later in a code list.

The code list covered key issues emerging from the interview questions and more specific patterns that became apparent during the data collection process. The authors adopted the approach used in Attride-Stirling (2001) in developing and controlling the code list.

The themes that emerged on the provision of non-audit services to audit clients were:

- ❖ Loss of auditors' independence
- ❖ Loss of public confidence in the audit process
- ❖ Economic environment
- ❖ Permissive auditing standards
- ❖ Effect on audit expectation gap.

Categorised response quotes from the participants used to inform the findings are collated under each of the above themes in Table 2. The category of respondent is identified by the bracketed references after each comment, as follows: large sized "big 4" audit firm practitioner 'L'; medium-sized firm audit practitioner 'M'; small firm audit practitioner 'S'; and pension fund administrator 'P'. Respondents are not identified by region in Table 2 to ensure the preservation of their anonymity.

Quotes from the interviewees on the identified themes are reproduced below in Table 2 to allow readers to make their own interpretations of results, after Latour (2005). The free-form nature of the responses leaves them open to a considerable degree of interpretation by readers. Readers may choose to interpret responses in the context of the group to which the

respondent belongs, or the manner of language in which a view was expressed. Some responses are difficult to take at face value while also remaining meaningful.

Further discussion of the answers given by respondents in Table 2 will be addressed in detail per theme in the findings section.

### **Table 2 here**

In Table 3, the percentage presented in each box indicates the number of affirmative perceptions of the research participants on the various themes and the difference constituting the expectation gap.

### **Table 3 here**

## **5. FINDINGS**

The scores for positively identifying each of the themes reveal high percentages in all themes, as illustrated in Table 3. This is a natural consequence of the thematic analysis, as an infrequently occurring view would not be identified as a theme. Results were further analysed to consider the responses from pension fund managers, who represent institutional investors, compared with those from auditors. Auditor responses were analysed across those from auditors from large (“big 4”), medium-sized and small practices. Statements by which respondents justified the view they expressed are also grouped within each theme discussed below.

### *5.1 Loss of independence*

The results presented in Table 3 reveal that 90% of all respondents, of whom 87% are auditors and 93% Pension Fund Administrators, positively identified provision of non-audit services with loss of independence. The theme arose in all discussions with respondents, as presented in Table 2. More Pension Fund Administrators than auditors supported their view with an explanation.

Of those not responding positively, from Table 2, one large firm auditor (L4) and one Pension Fund Administrator (P13) noted that an auditor could avoid threats to independence by clarifying their standpoint to the client. One medium-sized firm auditor (M2) concurred with (P13) that the threat to independence correlated with the size of the fee.



Of those responding positively, from Table 2, 10 auditors and five Pension Fund Administrators provided simple statements of agreement.

One large firm auditor (L3) made the intriguing statement that "...50% of his independence would be affected" and two Pension Fund Administrators (P9 and P15) believed non-audit services were discouraged by regulations.

One small firm auditor (S6) and two Pension Fund Administrators (P3 and P5) stated auditors should not undertake non-audit work for their clients.

One large firm auditor (L1) and one Pension Fund Administrator (P2) identified the threat to independence as self-review. Two Pension Fund Administrators identified the threats as overfamiliarity with (P7 and P10) and economic reliance on the client (P6 and P12).

The perceptions of auditors and Pension Fund Administrators on this theme appear closely aligned, confirming the findings of Salehi et al (2009), with large firm auditors and Pension Fund Administrators more likely to explain their view.

### *5.2 Loss of public confidence*

The results presented in Table 3 reveal that 77% of all respondents, of whom 73% are auditors and 80% Pension Fund Administrators, positively identified provision of non-audit services with loss of public confidence. As presented in Table 2, the theme arose in all discussions, with the exception of one Pension Fund Administrator (P3).

Of those not responding positively, from Table 2, one medium-sized firm auditor (M3) and one Pension Fund Administrator (P13) gave simple statements of disagreement, alongside the Pension Fund Administrator who did not identify the theme.

One Pension Fund Administrator (P9) stated the auditor possessed the expertise to put records in order. One small firm auditor (S7) noted an auditor was free to decline non-audit work according to his or her ethics, while a second (S4) stated the auditor would not keep the accounting records that he or she would audit.

Large firm auditor (L4) gave the enigmatic response "the public can think anything they like".

Of those responding positively, from Table 2, one medium-sized firm auditor (M2) qualified the threat to public confidence with a link to the value of the non-audit service fee. Five auditors and eight Pension Fund Administrators provided simple statements of agreement.

One small firm auditor (S3) referred explicitly to a threat to independence from self-review, which was mirrored by Pension Fund Administrators (P6) “(provision of) accountancy services is like beating the drum and doing the dancing”, and (P8) “you can’t prepare the account and audit yourself”.

Two small firm auditors (S2 and S4) related the loss of public confidence to overfamiliarity with the client.

A medium-sized firm auditor (M1) linked the loss of confidence with the fall of Enron, a Pension Fund Administrator (P12) stated it was a major cause of the expectation gap and (P5) suggested it should form the basis of an amended standard.

The above finding is in line with the study by Edelman and Nicholson (2011) referred to above, noting the significance of the failed Enron Corporation, and the impact on US legislation in the 2002 Sarbanes Oxley Act.

### *5.3 Economic environment*

The results presented in Table 3 reveal that 60% of all respondents, of whom 67% are auditors and 53% Pension Fund Administrators, positively identified the provision of non-audit services with the economic environment. This was the issue that arose with the lowest frequency, with four auditors and three Pension Fund Managers not discussing the theme.

Of those responding to, but not affirming, the link between non-audit services and the economic environment, from Table 2, one small firm auditor (S5) and two Pension Fund Administrators (P12 and P14) agreed that while the economy was bad, ethical integrity should continue to prevail. One Pension Fund Administrator (P9) believed integrity was unrelated to economic conditions, while another, (P6), believed adequate safeguards existed.

Of those responding positively, from Table 2, one auditor and one Pension Fund Administrator provided simple statements of agreement.

One small practice auditor (S2) attributed the link between non-audit services and the economic environment with a downward pressure on audit fees. The issues identified most frequently across all categories of respondent was the economic necessity of the auditor generating an adequate income in order to survive. This can be seen to drive auditors towards accepting non-audit work while regulations permit.

These views were the most emphatic and strongly expressed views of all themes. Highly charged language was used to explain the issues auditors faced citing survival, a need to pay bills and wages, unemployment and the difficulty of getting jobs.

This venting of frustration of both auditors and Pension Fund Managers as institutional investors was the most striking single finding of the research. However, Joe and Vandervelde's (2007) experimental research noted a downwards pressure on audit fees as a result of the benefits to auditor knowledge of non-audit services.

Other responses suggest a different view of the "environment" had been taken. One small practice auditor (S7) and one Pension Fund Administrator (P7) linked the environment with the permissive nature of the regulatory environment. A Pension Fund Administrator (P1) associated the environment with the conflicting interests of directors who, in substance, appointed the auditor then required them to report on stewardship, while another administrator (P2) referred obliquely to "our local issues".

#### *5.4 Allowed by the auditing standard*

The results presented in Table 3 reveal that 77% of all respondents, of whom 87% are auditors and 67% Pension Fund Administrators, positively identified provision of non-audit services with permissive auditing standards. Similar to section 5.3, some respondents did not identify permissive auditing standards as an issue; namely, one large firm auditor and three Pension Fund Administrators.

Of those not responding positively, from Table 2, one medium-sized firm auditor (M3) responded that non-audit services were beneficial, one Pension Fund Administrator (P10) declined to share a view as he or she was "not current", and an administrator (P14) stated that ethics should entail high standards even if this was not included in the regulations.

Of those responding positively, from Table 2, seven auditors and three Pension Fund Administrators provided simple statements of agreement that standards allowed, accepted or encouraged non-audit services.

One small (S3) and one medium-sized (M1) firm auditor felt independence was affected by standards allowing non-audit services, but recordkeeping and financial reporting was enhanced. This view was shared by two Pension Fund Administrators (P3 and P4).

One large firm auditor (L3) indicated there was nothing wrong with providing non-audit services if standards permitted. However, another large firm auditor (L2) and Pension Fund Administrator (P11) believed the provision of non-audit services should be regulated.

One small firm auditor (S6) suggested the permissive attitude towards non-audit services represented a loophole in the standard, while one Pension Fund Administrator (P8) pinpointed auditing standards as the source of the problem associated with the provision of non-audit services. Another small firm audit practitioner (S8) and three Pension Fund Administrators (P7, P12 and P15) claimed the permissive nature of auditing standards furthered auditor self-interest.

More auditors than Pension Fund Administrators identified audit standards as an issue related to non-audit fees. Otherwise, the mixed responses indicated a variety of opinions about whether the permissive attitude of auditing standards to non-audit services was viewed favourably or unfavourably. This reflects the uncertainty in empirical evidence on whether non-audit services enhance or detract from audit work, as noted in the literature review of Tepalagul and Lin (2015).

### *5.5 Weak provision in the auditing standard increased expectation gap*

The results presented in Table 3 reveal that 84% of all respondents, of whom 80% are auditors and 87% Pension Fund Administrators, positively identified the provision of non-audit services with an increasing expectation gap. Consideration of the theme generated mixed views from auditors, while Pension Fund Administrators shared the view of the existence of a positive link, with the exception of two who did not identify the issue.

Of those not responding positively, from Table 2, one large (L4) and one medium-sized (M2) firm auditor disagreed that non-audit services contributed to an expectation gap, while another medium-sized firm auditor (M3) declared that the gap could be bridged by educating the public.

Of those responding positively, from Table 2, six auditors and five Pension Fund Administrators provided simple statements of agreement.

Two small firm auditors noted their confidence in the financial statements contributing to the expectation gap (S1) and related to the threat posed to independence by self-review (S7). One medium-sized firm auditor (M1) referred to the case of Enron as an analogous contribution to the expectation gap.

One small firm auditor (S8) did not provide any consultancy to audit clients because of the contribution to an expectation gap.

Pension Fund Administrators who agreed with a contribution made by non-audit services to widening the expectation gap, identified a link between independence and the expectation gap (P8). Auditors work would be perceived as not being undertaken as it should (P3), the involvement of all “big 4” firms made this a major cause of the expectation gap (P12), and “when the client gives you additional services he will buy your conscience” (P15).

Qualified agreement was offered by two small firm auditors on the basis that the contribution to the expectation gap depended on the firm involved (S4) or the auditor’s failure to “draw the line” (S5). Pension Fund Administrators concurred with S5 on ‘line drawing’ (P9), or qualified their agreement depending on the service provided (P7 and P10) or the need for the public to be educated (P13).

Respondents’ perceptions of the effect of non-audit services on the expectation gap were mixed. The only auditors who expressed an opinion that non-audit services did not contribute to the expectation gap were from large or medium-sized firms. This view is consistent with the survey of Akinbowale and Babatunde (2017) and might be validated by the experimental research of Joe and Vandervelde (2007); thereby indicating the benefits of knowledge transfer to audit quality. However, perceptions would need to change for the “deficient standards” or “deficient performance” gaps to be narrowed, as defined by Porter (1993). This supports the views that the public needs to be educated.

## **6. CONCLUSION AND RECOMMENDATION**

By facilitating the emergence of themes from semi-structured interviews, this study has identified a widely-held view that providing non-audit services is an economic necessity for the survival of Nigerian audit practitioners. As a phenomenological study, the study has revealed environmental, legal, political and economic factors. This is evident from the study findings, which contribute to an increase in the audit expectation gap. The policy implications of the study include the identification of the need for review to recognise the current economic realities in rules for the appointment and removal of external auditors. This study finds that while auditors are allowed to offer non-audit services, competition for appointments may drive down auditing fees below the market price required for an effective independent audit; thereby indicating that packaging audit and non-audit services compromise independence, which follows on from the work of Joe and Vandervelde (2007). Based on overlapping information from the research participants, prevention of provision of non-audit services to audit clients by external auditors should be explored. This is in line with the evidence provided in the study conducted by Ghosh and Pawlewicz (2009) that this raised levels of fee income for auditors. The study opens the door for future global research in the same area; this is anticipated to enhance the practical impact of the current research and strengthen the contribution of the study to cover other countries worldwide, which will be an additional contribution of the present study.

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# **Non-Audit Fees and Auditor Independence: Nigerian Evidence**

## **Tables**

**Table 1**  
**Auditor respondents by size of audit practice and regions.**

Size	Region			Frequency	Percentage
	Northern	Eastern	Western		
Large “big 4” practice	1	2	1	4	27%
Medium-sized practice	1	1	1	3	20%
Small-sized practice	3	2	3	8	53%
Total	5	5	5	15	100%

**Table 2**  
**Provision of non-audit services to audit client – responses Audit Partners and Pension Fund Administrators**

‘L’ Large sized “big 4” audit firm practitioner, ‘M’: Medium-sized firm audit practitioner, ‘S’: Small-sized firm audit practitioner, and ‘P’: Pension fund administrator.

Themes				
1	2	3	4	5
<b>Loss of independence</b>	<b>Loss of public confidence</b>	<b>Economic environment</b>	<b>Allowed by audit standard</b>	<b>Increase in expectation gap</b>
“There will be <b>conflict or threat to independence</b> , so it is as if you are auditing yourself. There will not be sincerity there so that’s what I mean.” (L1)	“Handle such consultancy job like taxation. Owned by the same audit firm. Like I said before, there will be <b>conflict</b> , so that independence will not be there”. (L1)			“ <b>It definitely increases the expectation gap.</b> ” (L1)
“Yes, it will <b>impede independence.</b> ” (L2)	“Yes, there will be <b>loss of confidence</b> because the general public will look at the audit report as a man no man affair.” (L2)	“Yes, our economy is bad, but one should not compromise his integrity.” (L2)	“Our law should <b>be amended to discourage</b> taking other services from an audit client.” (L2)	“Definitely it will <b>help in widening the expectation gap.</b> ” (L2)
“At least <b>50% of his independence will be affected.</b> ” (L3)	“Yes, even now, many have started <b>losing confidence</b> in the audit process.” (L3)	“ <b>We need to pay our staff,</b> provided we have the capacity,” (L3)	“I don’t think there is anything wrong in providing tax or accounting services so long as <b>it is in the standard.</b> ” (L3)	“I do believe it <b>increases the expectation gap.</b> ” (L3)

Loss of independence	Loss of public confidence	Economic environment	Allowed by audit standard	Increase in expectation gap
<p>“To me, it will not if you explain your stand to the client.” (L4)</p>	<p>“The public can feel anything they like.” (L4)</p>	<p>“Yes, our <b>economic climate is too harsh</b> so the little you have, you will be praying for another job from the client.” (L4)</p>	<p>“<b>The standard encourages</b> us to do it but to make sure it is clearly stated in our engagement letter.” (L4)</p>	<p>“Well, I don’t believe it can increase the expectation gap.” (L4)</p>
<p>“His <b>independence will be impaired.</b>” (M1)</p>	<p>“Certainly, since the fall of Enron and WorldCom., people started <b>losing interest</b> in our services.” (M1)</p>		<p>“People may be, but it is another way of <b>ensuring that proper books are kept.</b>” (M1)</p>	<p>“<b>It will affect the gap.</b> Just look at an auditor in charge of the company in the Enron case was formally among one of the big 7 whom we are looking at as our role model.” (M1)</p>
<p>“It depends on the value to the overall audit income.” (M2)</p>	<p>“Yes, as I said earlier, it depends on the value of such services. If it is high, it <b>will affect public confidence.</b>” (M2)</p>	<p>“We need to engage in other services <b>in order to pay our bills.</b>” (M2)</p>	<p>“Yes, our <b>auditing standard allows</b> such services.” (M2)</p>	<p>“I don’t think it will affect the expectation gap.” (M2)</p>
<p>“It will <b>impede independence</b> or not will be on average.” (M3)</p>	<p>“I don’t think it will impede more than average public confidence.” (M3)</p>		<p>“Personally, I believe it is better for the auditor to handle a reasonable portion of NAS.” (M3)</p>	<p>“The public is educated. they know the scope of audit and that it will bridge the gap.” (M3)</p>

<b>Loss of independence</b>	<b>Loss of public confidence</b>	<b>Economic environment</b>	<b>Allowed by audit standard</b>	<b>Increase in expectation gap</b>
“In short, doing an accountancy job and auditing the same account you prepare will <b>influence the independence</b> of the auditor.” (S1)	“It will be <b>doubtful</b> because there is no checks and balances in such a situation.” (S1)	“The harsh <b>economic situation</b> in Nigeria.” (S1)	“The <b>standard encourages</b> other services, like accountancy services and tax, to be performed.” (S1)	“The reliability and public confidence in the financial statement will be in question so it <b>affects the gap.</b> ” (S1)
“It will <b>impede auditors’ independence.</b> ” (S2)	“The Professional Practice Monitoring Committee says that practice should rotate their staff so as to avoid over familiarity, which can <b>create doubt.</b> ” (S2)	“Sometimes we come ‘down’ in order to get our pay. So, it is an <b>environmental factor.</b> ” (S2)	“It is <b>acceptable</b> within the provision of the present auditing standard.” (S2)	“It <b>increases the expectation gap.</b> ” (S2)
“When you provide some services to your client, it will <b>impede your independence.</b> ” (S3)	“Nobody assesses himself and marks himself badly, so when an auditor prepares a financial statement and comes to audit that same financial statements, what do you expect? There will be <b>conflict.</b> ” (S3)	“In order to survive in our own <b>environment</b> , we take any additional services; be it accountancy or tax from an audit client.” (S3)	“Except the audit standard disallowed it, but now we provide such services even though it may affect independence. But it also <b>helps ensure the right thing is done.</b> ” (S3)	“No matter what we claim to be, provision of NAS <b>increases the expectation gap.</b> ” (S3)



<b>Loss of independence</b>	<b>Loss of public confidence</b>	<b>Economic environment</b>	<b>Allowed by audit standard</b>	<b>Increase in expectation gap</b>
<p>“<b>It will affect auditors’ independence</b> no matter how you look at it.” (S4)</p>	<p>“Yes, by being too close, people will <b>doubt your credibility.</b>” (S4)</p>	<p>“You know, in these days of <b>high-level unemployment</b>, we can take additional audit jobs.” (S4)</p>	<p>“It is stated in our engagement letter before we start the audit, so is <b>allowed.</b>” (S4)</p>	<p>“Well, it <b>can affect the expectation gap</b> depending on the firm.” (S4)</p>
<p>“The best is to avoid such services if you want to maintain your independence, otherwise you <b>lose your independence.</b>” (S5)</p>	<p>“I do not agree because the records used for accountancy services are not kept by the auditor.” (S5)</p>	<p>“We grab other services that come our way in <b>order to survive.</b>” (S5)</p>	<p>“It is not illegal since the <b>auditing standard allows</b> it, except the standard is reviewed to exclude it.” (S5)</p>	<p>“It <b>can increase the expectation gap</b> if one does not draw the line.” (S5)</p>
<p>“The bottom line is if you provide NAS, don’t audit; and if you audit, don’t provide NAS otherwise <b>there will be a loss of independence.</b>” (S6)</p>	<p>“<b>Definitely, it can erode public confidence</b> in an audit.” (S6)</p>		<p>“These are some of the <b>loopholes in the standard.</b>” (S6)</p>	<p>“Yes, it can <b>increase the expectation gap.</b>” (S6)</p>
<p>“<b>Auditor’s independence can be impaired</b> where you are supplying other services to an audit client.” (S7)</p>	<p>“Observe the ethics and you will even know when to say no to certain offers, whether they are ancillary work or any other such offer.” (S7)</p>	<p>“Some countries do not allow you to be a tax consultant to your audit client, but it is permitted by our <b>economic environment.</b>” (S7)</p>	<p>“Nothing says that your independence is lost because of rendering other services the <b>standards allows it.</b>” (S7)</p>	<p>“Naturally, when you render other services to audit clients, you are more or less becoming part of the system and it <b>will no doubt increase the gap.</b>” (S7)</p>
<p>“It <b>affects an auditor’s independence posture.</b>” (S8)</p>	<p>“When independence is in <b>question, public confidence will not be there.</b>” (S8)</p>	<p>“We do all that comes our way because there is <b>a high level of unemployment.</b>” (S8)</p>	<p>“The <b>standard allows</b> it because the regulators of the auditing profession want it for their own gain.” (S8)</p>	<p>“Handling other services, like accountancy, <b>will increase the expectation gap</b>, which is why we don’t do consultancy with audit clients in our firm.” (S8)</p>

<b>Loss of independence</b>	<b>Loss of public confidence</b>	<b>Economic environment</b>	<b>Allowed by audit standard</b>	<b>Increase in expectation gap</b>
<p>“Under those circumstances, <b>loss of independence</b> must be there.” (P1)</p>	<p>“Yes, because by providing ancillary services to audit clients, the <b>public won’t trust the auditor</b> again.” (P1)</p>	<p>“As I said, the <b>environment</b> has created a situation where the auditor doing his job the way he should, will run into problems with the person who appointed him.” (P1)</p>		<p>“Definitely, it will <b>affect the expectation gap.</b>” (P1)</p>
<p>“If auditors are rendering accounting services, you cannot prepare financial statements and simultaneously be the auditor...your <b>independence will be impaired.</b>” (P2)</p>	<p>“Yes, it can <b>affect public confidence</b> in the audit process and audit report.” (P2)</p>	<p>“You know we have an <b>environmental issue</b>...that is our local issues.” (P2)</p>		<p>“<b>It can affect the expectation gap.</b>” (P2)</p>
<p>“If the auditor provides a service other than audit, he must not be the one that does the audit, otherwise his <b>independence will be affected.</b>” (P3)</p>			<p>“An external auditor is needed to help by <b>making sure that all anomalies</b> he observed in the system are corrected by participating.” (P3)</p>	<p>“The public will think that the auditor is <b>not doing his work as it should be done.</b>” (P3)</p>

<b>Loss of independence</b>	<b>Loss of public confidence</b>	<b>Economic environment</b>	<b>Allowed by audit standard</b>	<b>Increase in expectation gap</b>
“It is a clear point that taking up ancillary services with audit clients will <b>affect auditors’ independence posture.</b> ” (P4)	“Yes, it can lead to <b>loss of public confidence.</b> ” (P4)			
“An audit firm that provides audit and assurance services should not at the same time provide non-audit services as <b>it impairs independence.</b> ” (P5)	“ <b>Erosion of public confidence</b> with the audit process and provide a platform for amending the present standard.” (P5)		“Yes, that is one of the loopholes in the standard, so it is there. But it is also a way of <b>making sure that correct things</b> are done.” (P5)	
“You see, you can’t be hard on someone that gives you food, so <b>it must affect your independence.</b> ” (P6)	“Yes, <b>people will lose confidence,</b> especially in accountancy services. It is like beating the drum and doing the dancing.” (P6)	“The ancillary services are handled by their consultancy outfit and I don’t see anything wrong with that.” (P6)	“ <b>The standard allows it.</b> ” (P6)	“Yes, it <b>will affect AEG</b> if the service questions auditors’ independence.” (P6)
“It brings too much familiarity that will, in turn, <b>affect independence.</b> ” (P7)	“I think it <b>reduces public confidence in the audit report.</b> ” (P7)	“All the big 4 firms do it so the law allows it and our <b>economic environment</b> too.” (P7)	“To me, auditors are <b>hiding too much in the auditing standard</b> to do whatever they like.” (P7)	“ <b>It will reduce credibility</b> and hence, increase the expectation gap.” (P7)

<b>Loss of independence</b>	<b>Loss of public confidence</b>	<b>Economic environment</b>	<b>Allowed by audit standard</b>	<b>Increase in expectation gap</b>
“It will bring the <b>independence of the auditor to question.</b> ” (P8)	“Sure, <b>sure, people will lose confidence;</b> you can’t prepare the account and audit yourself.” (P8)	“You know the <b>economy is bad when</b> they have to take additional services.” (P8)	“To me, the <b>auditing standards setting</b> is where the problem lies.” (P8)	“ <b>Yes,</b> auditors’ independence and the expectation gap have a close relationship.” (P8)
“I think IFAC discourages provision of NAS because of a <b>possible threat to independence.</b> ” (P9)	“To me, it will not because they have the expertise to put the records in order.” (P9)	“No matter the economic condition in Nigeria, taking ancillary services with audit clients will jeopardize their integrity.” (P9)	“Yes, provision of NAS is <b>permitted by the standard.</b> ” (P9)	“It will <b>affect the expectation gap</b> where the auditor is unable to draw the line and maintain his integrity.” (P9)
“You know, too much <b>familiarity brings contempt.</b> ” (P10)	“Yes, it will <b>erode public confidence in the audit claim.</b> ” (P10)	“They can’t because <b>they have to survive.</b> ” (P10)	“To me, I can’t say for sure because I am not current.” (P10)	“Tax and others <b>affect the expectation gap.</b> ” (P10)
“Provision of NAS or accountancy services will <b>impede independence.</b> ” (P11)	“Yes, it will also <b>affect public confidence</b> in the audit report.” (P11)	“Yes, especially for younger audit firms, you cannot avoid it. <b>They must survive.</b> ” (P11)	“The expectation gap will continue unabated unless the law prohibits such services to the audit client.” (P11)	“ <b>It will naturally affect the expectation gap.</b> ” (P11)
“Naturally, you can be hard on the person that is feeding you even when the law permits it. So, it will put <b>auditors’ independence to question.</b> ” (P12)	“ <b>Certainly, it will erode public confidence</b> and is the major cause of AEG.” (P12)	“Yes, I agree the economy is hard, but the auditor should maintain his integrity.” (P12)	“The <b>standard allows them to help their members.</b> ” (P12)	“As I have said earlier, it is the <b>major cause of the expectation gap</b> because all the big 4 firms are doing it.” (P12)

<b>Loss of independence</b>	<b>Loss of public confidence</b>	<b>Economic environment</b>	<b>Allowed by audit standard</b>	<b>Increase in expectation gap</b>
<p>“In the long run, it <b>will affect auditor’s independence.</b>” (P14)</p>	<p>“Certainly, it <b>will create some doubt</b> in the mind of the public.” (P14)</p>	<p>“You can’t because the economy is bad and do what is wrong.” (P14)</p>	<p>“<b>The standard allows it</b>, but we can’t take bribes simply because the standard did not say.” (P14)</p>	<p>“<b>It is a contributing factor to AEG.</b>” (P14)</p>
<p>“Yes, it will <b>affect auditors’ independence</b> because we are asked not to due to the possible threat to independence.” (P15)</p>	<p>“You can’t do accountancy work and at the same time audit the accounts, as the public <b>will doubt the credibility</b> of your report.” (P15)</p>	<p>“I agree, <b>economic factors can contribute to it.</b>” (P15)</p>	<p>“Yes, because the <b>regulators of audit practice tacitly allow</b> the creation of jobs for their members.” (P15)</p>	<p>“<b>It will affect AEG to a large extent</b> because when the client gives you additional services, he will buy your conscience and you will not talk.” (P15)</p>

**Table 3**  
**Summary of perceptions of the provision of non-audit services to audit clients and the associated causes and effects as represented by themes.**

No.	Themes	Affirmative responses: <u>Auditors</u>		Affirmative responses: <u>Fund Managers</u>		Affirmative responses: <u>All Respondents</u>	
		Freq. out of 15	%	Freq. out of 15	%	Freq. out of 30	%
1	Loss of independence	13	87%	14	93%	27	90%
2	Loss of public confidence	11	73%	12	80%	23	77%
3	Economic environment	10	67%	8	53%	18	60%
4	Allowed by audit standard	13	87%	10	67%	23	77%
5	Increase the expectation gap	12	80%	13	87%	25	84%