



Auditor Independence: Malaysian Accountants' Perceptions

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Abstract

Independence is the primary justification of the existence, and thus the hallmark of the auditing profession. It is recognized as the primary attribute to be maintained by auditors in all circumstances. This study attempts to explore the determinants of auditor independence as perceived by Malaysian accountants using a self-administered mail survey. It was evidenced from the survey that size of audit fees is the most important factor, followed by competition, size of audit firm, tenure, provision of management advisory service and finally audit committee. More specifically, the study indicates that (1) larger size of audit fees, (2) audit firms operating in a higher level of competitive environments, (3) smaller audit firms, (4) audit firms serving a given client over a longer duration, (5) audit firms providing MAS, and, (6) the non-existence of an audit committee, are perceived as having a higher risk of losing independence. This study provides a basis for the profession to establish policies relating to auditor independence. Also, it may assist policy makers and other relevant international accounting agencies in their attempt towards the international harmonization of auditing standards. The major contribution of this paper is that it supplies recent evidence on factors influencing auditor independence from the viewpoint of Malaysian accountants.

Keywords: Auditor independence, Malaysia, Management advisory services (MAS), Audit committee, Audit Fees, Firm size

Introduction

Media comments in the wake of Enron and other corporate scandals including WorldCom and Parmalat to name a few have ended to focus heavily on the issue of auditor independence (Raja Tun Uda, 2002). These financial scandals and corporate failures, thus, are proven to have had a detrimental effect on the public's perception of auditors. More worryingly, as been raised by O'Malley (1993), the issues related to independence are threatening the survival of accounting firms of all sizes and indeed it has the power to destroy the accounting profession as a whole. It is therefore, vital that auditors maintain their independence and ensure that they provide a high quality of auditing to ensure the credibility of financial information not only for the purpose of reducing the number of corporate scandals but most importantly the survival of their profession and the development of healthy financial and capital market (Abu Bakar, 2006).

The study aims to provide further understanding of the factors influencing auditor independence (hereafter referred to as AI) from the perspective of accountants in Malaysia. Among the significance of this study is that it provides recent input on the literature of AI. This is important since the issue of AI is ongoing and becoming more controversial nowadays, thus fresh studies on this issue should always be conducted to ensure its updated information. In addition, this article also offers important input to serve as a strong basis for the profession to establish policies relating to auditor independence, particularly in Malaysian context since empirical evidence regarding this issue have been relatively limited so much so that the accounting profession has had no choice but to rely on conjecture and assertion to establish

policy (Shockley, 1981). Providing empirical evidence from local context also can assist the policy makers and other relevant international accounting agencies in their attempt towards the international harmonization of auditing standards.

Auditor Independence

Independence has been described as “avoidance of situations which would tend to impair objectivity or permit personal bias to influence delicate judgement” (Carey et al., 1966). Auditor independence, in particular, implies “absence of influence or control in the matter of the auditor’s conduct, action and opinion” (AAA, 1973). It simply refers to the auditor’s ability to express his conclusions honestly and impartially. In discussing the foundation of the concept of auditor independence, Pany & Reckers (1983) emphasize that the concept of auditor independence is closely originated from the reason for the existence of auditing itself. According to them, the rationale for the external auditor’s work (i.e. independent audit) - indeed a primary justification for the existence of the public accounting profession - arises from the need for reliable financial information

According to the By-Law B-1.4 (1) issued by Malaysian Institute of Accountants (MIA), independence requires both (a) independence of mind and (b) independence in appearance (MIA, 2006). Independence in fact (or actual independence) can be defined as the auditor’s state of mind and his/ her ability to maintain a proper attitude in the planning of his audit program, the performance of his verification work, and the preparation of his report (Mautz & Sharaf, 1961). On the other hand, independence in appearance (or perceived independence) refers to the public’s or others’ perceptions of the auditor’s independence. To be seen to be independent, an auditor should be able to demonstrate that there is no threat to his or her independence such that an outsider would not doubt the auditor’s objectivity (Messier & Boh, 2002). This notion of independence is one of the cornerstones of auditing theory and the *sine qua non* of auditing practice (Wolnizer, 1987, as quoted in Patel & Psaros, 2000). Both actual as well as perceived auditor independence are critical elements in the maintenance of public confidence in the auditing profession (Pany & Reckers, 1980). However, for this study, we will only focus on ‘independence in appearance’, since the actual independence of an auditor is unobservable.

There have been an increasing number of studies on perceptions of auditor independence (PAI) on non Anglo-American countries. Examples are Dykxhoorn & Sinning (1981) in German, Gul (1989) in New Zealand, Gul & Tsui (1992) and Lau & Ng; (1994) in Hong Kong, Hudaib (2003) in Saudi Arabia and Alleyne et al. (2006) in Barbados to name a few. In Malaysia, to our knowledge, there are only three published studies examining the factors influencing PAI (i.e. Gul & Teoh, 1984; Teoh & Lim 1996; Abu Bakar et al. 2005). The study by Gul & Teoh (1984) investigate the effects of combined audit and management consulting services by public accounting firms on a sample of the Malaysian public comprising public accountants, bankers, managers and shareholders. They found that the expansion by audit firms into non-audit services reduced their confidence in the auditor’s independence. It was also found that shareholders believe that auditors could still remain independent if the audit firms provide non-audit services, while there are no definite conclusions for other categories of respondents.

On a separate study, Teoh & Lim (1996) investigate the effects of five selected variables on the PAI of Malaysian public and nonpublic accountants. They employ a repeated measures experimental design. Results show a large audit fee received from a single client is the most important factor leading to the impairment of PAI, followed by the provision of management consultancy services. The non-rotation of audit firms is not a dominant factor. The formation of audit committees is found to have a strong positive impact on enhancing auditor independence, while the positive impact of disclosure of non-audit fees is considerably less. The present study will complement the study by Teoh & Lim (1996) in terms of its contribution for a more recent data on perceived independence by accountants since Teoh & Lim study was done more than a decade ago.

The more recent study conducted in Malaysia is by Abu Bakar et al. (2005). This study surveyed the users of financial statements in particular 86 commercial loan officers in Malaysian-owned commercial banks using mail questionnaires. Results indicate that factors including (1) smaller audit firms, (2) audit firms operating in a higher level of competitive environments, (3) audit firms serving a given client over a longer duration, (4) larger size of audit fees, (5) audit firms providing MAS, and, (6) the non-existence of an audit committee, are perceived as having a higher risk of losing independence. Audit firm size is the most important factor, followed by tenure, competition, audit committee, MAS and size of audit fee. This present research is hoped to provide more Malaysian evidence regarding PAI, in particular from the preparer (i.e. accountants) perspective.

Determinants of Auditor Independence

The majority of empirical studies on the PAI focused upon finding the significance of the factors which potentially influence independence, and in looking whether these factors are positively or otherwise related with PAI (e.g. Pany & Reckers, 1980; Gul, 1989; Gul & Tsui, 1992). Among the factors that affect PAI that have been studied are (a) the effects of gifts (e.g. Pany & Reckers, 1980), (b) the purchase discount arrangement (e.g. Pany & Reckers, 1980), (c) the

audit-firm size (e.g. Shockley, 1981; Gul, 1989), (d) the provision of management advisory services (MAS) by the audit firm (e.g. Shockley, 1981; Knapp, 1985; Gul, 1989; Bartlett, 1993; Teoh & Lim, 1996), (e) the client's financial condition (e.g. Knapp, 1985; Gul, 1989, Gul & Tsui, 1992), (f) the nature of conflict issue (e.g. Knapp, 1985), (g) the audit firm's tenure (e.g. Shockley, 1981; Teoh & Lim, 1996), (h) the degree of competition in the audit services market (e.g. Knapp, 1985; Gul, 1989), (i) the size of the audit fees or relative client size (e.g. Gul & Tsui, 1992; Bartlett, 1993; Teoh & Lim, 1996; Pany & Reckers, 1980) and, (j) the audit committee (e.g. Gul, 1989; Teoh & Lim, 1996).

This study, however, will be focusing only on six of those factors which are deemed to be the relatively important factors in influencing PAI; (i) size of audit firm; (ii) level of competition in the audit services market; (iii) tenure of audit firms serving the needs of a given client; (iv) size of audit fees received by audit firms; (v) provision of managerial advisory services by audit firms to the audit clients; and (vi) the existence of audit committee.

Size of Audit Firm

Larger audit firms are often considered to be more able to resist pressures from management (i.e. higher auditor's independence). This is proven by almost all of the empirical studies that attempted to find the relationship between audit firm size and AI, whereby they found that there is a positive relationship between them (DeAngelo, 1981b; Shockley & Holt, 1983; Nichols & Smith, 1983; Dopuch and Simunic, 1980; McKinley et al., 1985; Shockley, 1981; Gul, 1989; Alleyne et al., 2006; Abu Bakar et al., 2005). In fact, it has been argued that certain characteristics inherent in small audit practices may increase the danger of impairment of independence, for example, the tendency toward a more personalized mode of service and close relationship with the client (Shockley, 1981). However, as pointed out by Goldman & Barlev (1974), one should not conclude that large CPA firms are immune to pressures from their clients. More to the point, the few court cases which challenge the assumption that CPA firms acted independently indicate that the use of a large CPA firm is no guarantee of its ability to resist pressures from clients, as happened with Arthur Andersen and Enron.

Level of Competition in the Audit Services Market

Competition has been identified as the most important environmental change or external factor affecting auditor independence (Shockley, 1981). Firms operating in an intensely competitive environment may have difficulty remaining independent since the client can easily obtain the services of another auditor. A number of empirical studies have proven that the high level of competition in the audit firm has resulted in less auditor independence (e.g. Shockley, 1981; Alleyne et al., 2006; Abu Bakar et al., 2005). Gul (1989), however, found the opposite. In explaining this, Gul argued that the existence of competition caused auditors to be more independent and create a favorable image in order to maintain their clientele.

Tenure of an Audit Firm Serving the Needs of a Given Client

An audit firm's tenure, which is the length of time it has been filling the audit needs of a given client, has been mentioned as having an influence on the risk of losing an auditor's independence. Most writers, who discuss the relationship between tenure and AI, support this view (e.g. Alleyne et al., 2006; Abu Bakar et al., 2005). A long association between a corporation and an accounting firm may lead to such close identification of the accounting firm with the interests of its client's management that truly independent action by the accounting firm becomes difficult (U.S. Senate, 1976). Mautz & Sharaf (1961) pointed out that complacency, lack of innovation, less rigorous audit procedures and a learned confidence in the client may arise after a long association.

The US Congressional Subcommittee on Reports, Accounting and Management (the "Metcalf Committee" [1976]) considered that the above dangers are serious enough to recommend the mandatory rotation of auditors as a possible remedy. Rotation ensures that the auditor remains independent since tenure will be limited and any vested interest will no longer be relevant (Teoh & Lim, 1996). Nevertheless, this suggestion has been opposed (e.g. Shockley 1981; DeAngelo 1981a). In Malaysia specifically, the length of audit tenure and the possible effect of switching on auditor independence is still unclear and not explicitly addresses in any of the relevant Malaysian official documents (Note 1) (Abdul Nasser et al., 2006) though in the year 2002 the Chairman of the MASB then had announced the intention of the board to make it mandatory to rotate the audit firm once every five years (The Edge, 2002). In studies conducted by Shockley (1981) and Teoh & Lim (1996) however, tenure was not found to have a significant impact on perceptions of independence.

Size of Audit Fees Received by Audit Firm (in relation to total percentage of audit revenue)

Large size of audit fees is normally associated with a higher risk of losing the auditor's independence. The IFAC's Code of Ethics for Professional Accountants (1996, para 8.7) suggest that client size (measured from size of fees) could raise doubts as to independence. In a similar development, the EFAA (October, 1998, p.4) clearly states that, 'the (total) fee from one client should not exceed a certain percentage of the total turnover of the audit firm'. In Malaysia the MIA By-Law (Section B-1.98 on Professional Independence) has emphasized that

“if the total fees (arising from assurance and non-assurance services) generated by one assurance client or its related entities exceed 15% of the firm’s total fees in each year over two consecutive financial periods, financial dependency shall be considered to exist, in which case, a self-interest threat to independence is created. In such event, the only course of action is to refuse to perform or withdraw from the assurance engagement”.

This 15% criterion has also been the level generally used by the ICAEW and Australia at which auditors have to consider their independent position.

Most empirical studies conducted on size of audit fees do not look at that factor per se; instead they inter-relate it with other factors. For example, Shockley (1982) suggests that the adverse effects of MAS, the size of the audit firm and competition on a third party’s PAI actually arise because of the linkage of these variables to audit fees. Nevertheless, there is a study that proves otherwise. For example, Gul (1991) proven that each independence-related variable namely MAS, competition and the audit firm size, affects bankers’ PAI in its own right. He also found size of audit fees to be an important determinant of bankers’ PAI. Another study related to the size of audit fees was by Pany & Reckers (1983). They noted that the large size of the client’s audit fee (measured as a percentage of office revenues to the audit firm), though do not show any significant impacts on PAI, have influenced respondents to feel less confidence in the auditor’s independence.

Management Advisory Services (MAS)

Management advisory services may include investment banking, strategic management planning, human resource planning, computer hardware and software installation, internal audit outsourcing (AICPA, 1997), risk assessment and business performance management. An extensive debate is raging in the literature about the compatibility of consulting and auditing service. In line with this, several empirical surveys were conducted in order to find how third parties, auditors and firms view this issue. The results are, however, inconclusive, suggesting that the effect of MAS on perceptions of auditor independence is complex (Goldman & Barlev, 1974; Gul, 1989; Shockley, 1982; Coreless & Parker, 1987) and other factors such as cultural differences of the subjects may also be a significant factor in the way MAS is viewed in the context of auditor independence.

Early research related to financial statement users indicated that auditor independence is negatively affected when non-audit services are performed for audit clients (e.g. Shockley, 1981; Pany & Reckers, 1983, 1984; Reckers & Stagliano, 1981; Knapp, 1985; Alleyne et al., 2006; Abu Bakar et al., 2005; Krishnan et al., 2005). They believe that these collateral services create a working relationship between the auditor and the client that is too close and that the provision of MAS negatively affected PAI.

Contrary to the above, some other studies found a positive relationship between MAS provision and PAI. They believe that MAS provision enhances the auditor’s knowledge of the client, thus increasing the auditor’s objectivity (see, for example, Goldwasser, 1999; Wallman, 1996). According to Goldman & Barlev (1974) who support this view, the addition of management services increases the power and independence of the auditors. They argued that this occurs because most consulting-type services are non-routine and because these services benefit the client firm directly. Consequently, the replacement of the consulting auditor may result in a loss of valuable advice to the firm. The bargaining position, therefore, becomes stronger; s/he is better equipped to resist interference in the performance of auditing duties and is more likely to retain independence. Finally, there are studies that have shown that the provision of MAS has no effect on PAI (e.g. McKinley et al., 1985; Coreless and Parker, 1987)

Audit Committees

An audit committee is a selected number of members of a company’s board of directors whose responsibilities include helping the auditors remain independent of management (Arens et al., 1999). For that reason, there is much support to suggest a positive relationship between audit committees and auditor independence, which means that the existence of an audit committee will enhance auditor’s independence. Teoh & Lim (1996) in their study find that the formation of audit committees has a strong positive impact on enhancing auditor independence. Similarly, Patten & Nuckols (1970), Knapp (1985) and Lau & Ng (1994) find that the existence of an audit committee increases the likelihood of bankers’ approving a loan, which is a reflection of an increased confidence in the auditor. On the contrary, Gul (1989) finds that audit committees did not significantly affect the perceptions of auditor independence.

Malaysian Accounting and Auditing Profession

Malaysian Institute of Accountants (MIA) is the authoritative body which is empowered by the Accountants Act, 1967 to regulate the practice of the profession of accountancy in Malaysia. The objectives of its regulatory role are to ensure that all members comply with professional and ethical standards in discharging their professional responsibilities and to ensure that all members exhibit the highest standards of professionalism, competency and integrity expected of the profession (MIA, 2006). The Institute has also focused on several critical areas such as regulatory changes and continuous education and training in facing global challenges. More specifically, it is actively involved in any attempt by the Malaysian Accounting Standards Board (MASB) to bring about awareness of accounting standards by

encouraging seminars and training programmes. MASB is an independent authority which develops and issues accounting and financial reporting standards established under the Financial Reporting Act 1997 (the Act). By and large, it adopts the International Accounting Standards (IAS). Moving forward, the MIA continues to keep pace with international best practices and standards such as those issued and recommended by the International Federation of Accountants (IFAC). With regards to qualification in becoming a Certified Public Accountant, the only local body in Malaysia which conducts a professional accountancy examination recognised under the Accountants Act 1967 is the MICPA (Malaysian Institute of Certified Public Accountants). With regards to size of audit firms in Malaysia, about 91.4% of Malaysian audit firms fall into the category of small firms with one to two partners. While medium size audit firms with three to eight partners constitute 7.5% of the population of audit firms, the remaining figure of 1.1% are of the large size audit firms with more than 9 partners.

Research Methodology

Research Questions

The following research questions have been developed mainly based on the development of literature on auditor independence:

Question 1: Do the accountants think that the six factors (i.e. audit firm size, competition level, tenure, size of audit fees, management advisory services and audit committee) have any influence on an auditor's independence?

Question 2: Which of the six factors (i.e. audit firm size, competition level, tenure, size of audit fees, management advisory services and audit committee) is the most important factor influencing auditor independence?

Question 3: What kinds of relationships (i.e. its direction) exist between the six factors (i.e. audit firm size, competition level, tenure, size of audit fees, management advisory services and audit committee) and the auditor's independence?

Data Collection

The subjects are accountants in Malaysia. They were selected as the sample population of this study because they could represent not only the preparers of financial statements (Jenkins & Krawczyk, 2001), but also the users (e.g. in Abdul Rahman, 2001). Accountants are professional people who have the qualification and training necessary in making informed judgements about the issue on auditor independence (Teoh & Lim, 1996). Also, they are among the sophisticated financial statement users who would understand the importance of the independent audit function. More interestingly, responses from accountants would also represent the views of the ordinary investor's group since those ordinary investors who do not have an accounting background would seek their advice for the purpose of making investment decisions (Abdul Rahman, 2001).

Data were collected using the mail survey method. This method is chosen not only because it is quick, inexpensive, efficient and accurate means of assessing information about the population (Zikmund, 2000), but most importantly due to the notion that survey is the best vehicle to measure perceptions as highlighted by Carmichael & Swieringa, (1968) in Beattie et al. (1999). In this study, since perceived independence represents opinions of people, the survey method, thus, can be considered as the most appropriate method.

The questionnaire, adapted from Abu Bakar et al. (2005) with slight modification particularly on its sequence, included two sections. First section consists of three main questions while the second question tries to elicit the respondents' demographic data including their age, gender, race, years of experience in present job as well as their level of education. Using Abu Bakar et al. (2005) questionnaire enabled us to compare our findings with their study on different subjects, i.e. commercial loan officers, who are among the users group. The first question asked the respondents whether they think each of the six factors listed has any influence on auditors' independence. To answer, respondents will have to circle either 'yes' or 'no'. However, at this point, the direction and the strength of these relationships are not explored. Next question is meant to test the strength of the relationships between the six factors and AI. It requires the respondents to assume that all the six factors have some influence on the auditor's independence. They were then asked to assign a unique number from 1 to 6 to all the six factors according to the factors' importance in influencing their PAI, with number 1 signifying the most important factor and number 6 as the least important factor. The third or last question tried to explore the direction of these relationships. It asked subjects to indicate whether they strongly agree ('1'), agree ('2'), slightly agree ('3'), neutral ('4'), slightly disagree ('5'), disagree ('6') or strongly disagree ('7') with the statements given. Each statement provides either a positive or negative relationship between the factors and auditor independence. The 7-point Likert-scale was provided based on past studies and thus for comparable purposes.

In total, 500 questionnaires were sent out. Since all practicing accountants in Malaysia must be registered as MIA members, the accountants list is extracted from the MIA Membership Directory which is kept confidential by the MIA. For that reason, researchers have less control on the selection process of respondents as this can only be done by the MIA. Researchers however have requested that MIA uses random selection and also exclude the public accountants. Accompanying each questionnaire were two letters; first is from the MIA certifying that the researchers are accounting

lecturers undertaking a research and the second from the researchers explaining the nature and purpose of the research, the respondents' role in answering the questionnaires and provides assurance of complete confidentiality. Self-addressed and post-paid envelopes were provided by the researchers to facilitate the process. No second mailing was conducted because the questionnaires were completed anonymously.

Results and Discussions

A total of 72 and 2 of completed and incomplete questionnaires were received respectively, producing usable replies of 14.4%. This response rate can be considered as acceptable since it falls between 10 and 50 per cent as suggested by Saunder et al. (2003). The respondents were a heterogeneous group with an average age of 36.7 years (standard deviation 6.9, range from 24 to 54 years) and a mean experience as accountants of 8.8 years (standard deviation 5.6, range from 1 to 22 years).

Factors Influencing Auditor Independence

Overall, all factors being tested are seen by accountants as having some kind of influence on AI, though the percentages of respondents' agreement range from 94.4 % to 70.8% (refer to Table I). This support the earlier findings by Abu Bakar et al. (2005) where they found all these six factors do have some kind of relationship with AI. While majority of the respondents (i.e. 94.4%) perceived that level of competition in the audit service market has some influence on AI, the existence of audit committee in the audit client company being least perceived as having any influence on AI with only 70.8% supporters. Other factors including (1) the audit firm size, (2) size of audit fees received by the audit firm. (3) the tenure of an audit firm serving the needs of a given client, and (4) the provision of management advisory services by an audit firm to the audit client company, all falls in between the previous two factors with 88.9%, 84.7%, 81.9% and 72.2% respectively.

"Take in Table I"

Strength of the Factors Influencing Auditor Independence

According to the ranking, the most important factor in influencing AI as perceived by the accountants is (1) the size of audit fees, followed by (2) the level of competition among audit firm, (3) the size of the audit firm, (4) the tenure of an audit firm, (5) the provision of management advisory services and finally (6) the existence of an audit committee (refer to Table II). In general, these findings do not confirm the results from earlier study conducted in Malaysia by Abu Bakar et al. (2005). Most interestingly, it completely contradicts Abu Bakar et al.'s study in the sense that in the latter study it was discovered that size of audit fees as the least important factor influencing AI, while this present study found otherwise whereby that factor is ranked the most important factor.

"Take in Table II"

In explaining this difference, one may want to relate to the fact that the MIA of which the respondents are the members, has recently introduced (in its By-Law on Professional Independence) the 15% threshold of the size of audit fees as a benchmark of independency of a particular auditor on its client. This step has perhaps increased the accountants' awareness and hence responsiveness towards this particular factor, and as reflected in this study, this factor has been perceived as a relatively crucial factor in influencing AI. It is therefore, safe to say at this point that the policy actions taken to set the maximum size of audit fees in particular have a strong (positive) consequences on the accounting profession as a whole and AI in particular. Abu Bakar et al.(2005) on the other hand, in justifying the reason that size of audit fees is relatively less important among the loan officers understandably mentioned that normally only the audit firms themselves know the size of audit fees, as a percentage of their total revenue which they receive from their clients. The loan officers themselves therefore do not have that information readily available.

On a separate note, when the ranking of importance is compared with the mode, it can be seen that both are showing almost similar results, except for the first two factors, where the modes are reflecting the factors' lesser importance.

Comparing results from Table I and Table II, there are at least for three factors of which the results are found consistent. In Table I, three factors, namely (i) tenure, (ii) provision of MAS, and (iii) existence of audit committee, are found as the factors with the relatively higher percentage of responses that mentioned they have '*no influence*' on AI, with 18.1%, 27.8% and 29.2% respectively. In the same way, the respondents' views regarding those factors are reflected here in Table II when they rank those three factors as the three least important factors in affecting AI, exactly in the same order as in Table I.

One study which involved factors ranking is Shockley (1981). Shockley reports the competition variable was ranked as most important, followed by the size and MAS factors. Thus, to a certain extent, the results of this study seem consistent with Shockley's particularly in terms of the factors' sequence of importance in influencing AI.

Directions of the Factors Influencing Auditor Independence

Table III shows the frequency of occurrence and percentages for the level of agreement by accountants for each of the factors and their relationships with AI.

“Take in Table III”

“Take in Table IV”

Table IV above shows the mode (or most common response) for each question regarding the respondents' level of agreement with the statements given. The mode or the majority of the respondents *agree* that; (i) the larger the size of an audit firm and (ii) existence of an audit committee in the audit client company - the greater the auditor independence will be. The majority also *agree* that; (i) the higher the level of competition among audit firms, (ii) the longer the duration an audit firm serves an audit client, (iii) the larger the amount of audit fees paid by the audit client company to the audit firm (in relation to the total percentage of audit revenue), and (iv) the provision of management advisory services by the audit firm to the audit client company; the more likelihood that auditor's independence will be impaired. All these are parallel those findings in Abu Bakar et al.(2005). This may indicate the indifferences between the opinions of loan officers and accountants in terms of the direction of the relationship of the factors being tested and AI.

More specifically, for the firm size and audit committee factor, the mode tend to agree with the positive relationship between the factors and AI, while for the other factors, the mode tend to agree with the negative relationship between those factors and AI. Results also show that the majority neither takes the position of “strongly agree” nor “strongly disagree”. They seem to prefer choosing a more moderate position by choosing a mere agree (or disagree), or, slightly agree (or disagree). Likewise, Abu Bakar et al. (2005) showed exact similar situations.

Not only that, results from this study also show consistent results with those of Abu Bakar et al. (2005), in one additional aspect. When the modes of the two contradicting relationship/ statements are compared, we will apparently find that if the mode is to agree (or slightly agree) with one direction of the relationship, the mode of the opposite direction will be to disagree (or slightly disagree). This remains true for all of the six factors. Perhaps this reversal of answers happens because most respondents captured that the first six questions and the last six questions are dependant on each other (please bear in mind that out of the twelve questions statements given, the last six questions are stated in just the reverse manner of the first six). Thus, they tend to answer the questions in a mirror image to each other.

“Take in Table V”

The statement that has been “agreed” most by the respondents according to ranking is that; (1) ‘the higher the level of competition among audit firms, the more likelihood that the auditor's independence will be weakened’. This is then followed by the statement (2) ‘the longer the duration an audit firm serves an audit client, the more likelihood that auditors' independence will be impaired’, and (3) ‘the larger the size of audit fees paid by the audit client company to the audit firm (in relation to the total percentage of audit revenue), the more likelihood that it will weaken the auditor's independence’. After that, it is followed by another three statements which are being equally agreed by accountants. These include; (4a) ‘the larger the size of an audit firm, the greater the auditor's independence’, (4b) ‘auditor's independence will be weakened if the audit firm provides management advisory services to the audit client company’, and (4c) ‘the existence of an audit committee in the audit client company may enhance an auditor's independence’.

On the other hand, the statement that has been “disagreed” with most by the respondents, according to ranking, is; (1) ‘the smaller the size of an audit firm, the greater the auditor's independence’. This is then followed by the statement (2) ‘the shorter the duration an audit firm serves an audit client, the more likelihood that auditor's independence will be weakened’, (3) ‘the smaller the amount of audit fees paid by the audit client company to the audit firm (in relation to the total percentage of audit revenue), the more likelihood that it will weaken the auditor's independence’, (4) ‘the existence of an audit committee in the audit client company may not enhance the auditor's independence’, (5) ‘the auditor's independence will not be weakened if the audit firm provides management advisory services to the audit client company’, and finally, (6) ‘the lower the level of competition among audit firms, the more likelihood that auditor's independence will be weakened’. These results do not completely support those of Abu Bakar et al. (2005) although they both do not greatly differ.

Nevertheless, there are some aspects in which this study supports earlier studies. For example, in prior studies, there are either none or very few supporters for the positive relationship between (i) size of audit fees and (ii) tenure with AI, as well as the negative relationship between firm size and AI. Quite in line with that, in this study, it is found that these three statements obtain the relatively lowest means regarding the degree of agreement by the respondents. In other words, these statements are being disagreed with most by the respondents compared to other relationships for other factors. These two circumstances show some consistencies between this study's results with those done previously. It is, however, noted that this study marginally supports earlier studies including Abu Bakar et al. (2005) in the sense that in this study, the existence of an audit committee was not found to be greatly and positively influence AI as in the case of prior studies.

Conclusions

It is evidenced from this study that the Malaysian accountants perceived the following factors as important in influencing auditor's independence; they are, (1) size of audit fees, (2) level of competition among audit firms, (3) audit firm size, (4) tenure of an audit firm serving the needs of a given client, (5) provision of management advisory services, and finally (6) existence of an audit committee. These factors are arranged according to its degree of importance as perceived by the Malaysian accountants. The size of audit fees is considered the most important factor unlike in the same study done in Malaysia on loan officers (Abu Bakar et al., 2005) whereby that factor was considered the least important factor.

Factors including (1) the size of an audit firm and (2) the existence of an audit committee are perceived by Malaysian accountants as having positive relationship with auditor independence. In particular, accountants generally perceived that the larger the size of an audit firm, the more likely it is that it may enhance the auditor's independence. The existence of an audit committee in an audit client company is also believed to improve the external auditor's independence. For the other four factors, namely (3) the level of competition among audit firms, (4) an audit firm's tenure of service, (5) the size of audit fees, and (6) the provision of management advisory services, a negative relationship between them and auditor independence seems to gain more support from the accountants. They tend to believe that an auditor's independence is more easily impaired in four situations. Among the situations are when there is a higher level of competition among audit firms as compared to when the competition level is lower. Secondly, when there is a longer duration of service provided by the auditor for a given client as compared to when the auditor serves a given client over a shorter duration of time. Thirdly, when there is a larger size of audit fees provided by the audit client to the auditor as compared to when the auditor receives a smaller size of audit fees. Finally, when there is management advisory services (MAS) provided by the auditor to its audit client as compared to when there is no provision of MAS by the auditor to its audit client. In all these four situations, accountants believe that the auditor's independence will easily be weakened. The above findings on relationships between factors and AI basically support prior study by Abu Bakar et al. (2005) to certain extent.

The foremost limitation of the study is that it only considers each factor per se. It ignores any interaction effects which may exist between any two factors. For example, in a few of the prior studies, they find the interaction effects between (1) firm size and fees, (2) competition and tenure, (3) fees and MAS, and, (4) fees and competition. It is suggested that further studies could be undertaken by adding subjects such as investors and financial analysts. Comparisons could be made among these three groups which represents preparers (i.e. accountants) and users (i.e. investors and financial analysts).

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Note

Note 1. This includes Companies Act 1965, the Security Commission regulations, approved auditing standards, etc.

Table I. Frequency and Percentage Indicating ‘Yes’ and ‘No’ Regarding Factors Which Influence Auditors’ Independence

Factors (ranking according to ‘Yes’)	Firm Size (2)		Competition (1)		Tenure (4)		Fees (3)		MAS (5)		Audit Committee (6)	
	Freq.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Yes	64	88.9	68	94.4	59	81.9	61	84.7	52	72.2	51	70.8
No	8	11.1	4	5.6	13	18.1	11	15.3	20	27.8	21	29.2
Total	72	100.0	72	100.0	72	100.0	72	100.0	72	100.0	72	100.0

Table II. The importance of factors in influencing AI (1-Most important; 6-Least important): The mean and rank of factors

Factors	Mean Score	Rank	Mode
Firm Size	3.17	3	4
Competition	3.06	2	3
Tenure	3.68	4	4
Fees	2.85	1	1
MAS	3.72	5	5
Audit Committee	4.33	6	6

Table III. Level of Agreement with Positive and Negative Relationship between Each Factor and Auditor Independence: Frequency and Percentage of Occurrence of Responses

Factors	R/shi p		1 Strongly Agree	2 Agree	3 Slightly Agree	4 Neutral	5 Slightly Disagre e	6 Disagree	7 Strongly Disagree
Firm Size	+ve	Freq.	10	30	12	7	4	7	2
		%	13.9	41.7	16.7	9.7	5.6	9.7	2.8
	-ve	Freq.	0	6	4	10	12	29	11
		%	0	8.3	5.6	13.9	16.7	40.3	15.3
Competition Level	+ve	Freq.	3	7	7	11	19	19	6
		%	4.2	9.7	9.7	15.3	26.4	26.4	8.3
	-ve	Freq.	15	29	19	3	3	3	0
		%	20.8	40.3	26.4	4.2	4.2	4.2	0
Tenure of Services	+ve	Freq.	2	3	10	7	17	29	4
		%	2.8	4.2	13.9	9.7	23.6	40.3	5.6
	-ve	Freq.	15	31	17	2	2	5	0
		%	20.8	43.1	23.6	2.8	2.8	6.9	0
Size of Audit Fees	+ve	Freq.	1	10	7	10	9	28	7
		%	1.4	13.9	9.7	13.9	12.5	38.9	9.7
	-ve	Freq.	18	28	10	7	5	4	0
		%	25	38.9	13.9	9.7	6.9	5.6	0
Management Advisory Services	+ve	Freq.	0	11	7	15	11	20	8
		%	0	15.3	9.7	20.8	15.3	27.8	11.1
	-ve	Freq.	11	24	13	13	6	5	0
		%	15.3	33.3	18.1	18.1	8.3	6.9	0
Audit Committee	+ve	Freq.	6	31	15	7	7	4	1
		%	8.3	43.1	20.8	9.7	9.7	5.6	1.4
	-ve	Freq.	1	11	7	7	19	21	6
		%	1.4	15.3	9.7	9.7	26.4	29.2	8.3

Table IV. Level of Agreement with Positive and Negative Relationship Between Each Factor and Auditor Independence: Mode for Each Factor

Factors	Relationship	Agree/ Disagree Mode
Firm Size	Positive	2 (agree)
	Negative	6 (disagree)
Competition Level	Positive	5 (slightly disagree)
	Negative	2 (agree)
Tenure of Service	Positive	6 (disagree)
	Negative	2 (agree)
Size of Audit Fees	Positive	6 (disagree)
	Negative	2 (agree)
MAS	Positive	6 (disagree)
	Negative	2 (agree)
Audit Committee	Positive	2 (agree)
	Negative	6 (disagree)

Table V. Mean Score of the Level of Agreement for Each Factor and Its Rank (1-Strongly agree; 7-Strongly disagree)

Factors	Relationship with Auditor Independence	Mean	Rank (according to degree of agreement)
Size of Audit Firm	Positive	2.92	4
	Negative	5.21	10
Level of Competition	Positive	4.63	5
	Negative	2.43	1
Tenure of Service	Positive	4.90	9
	Negative	2.44	2
Size of Audit Fees	Positive	4.78	8
	Negative	2.51	3
Management Advisory Services	Positive	4.64	6
	Negative	2.92	4
Audit Committee	Positive	2.92	4
	Negative	4.65	7