FACTORs LIMITING THE EXTERNAL AUDITORS INDEPENDENCE IN THE AUDITING PROFESSION

BY

MOGERE B. STELLA

UNITED STATES INTERNATIONAL UNIVERSITY
NAIROBI

SUMMER 2003
FACTORS LIMITING THE EXTERNAL AUDITORS INDEPENDENCE 
IN THE AUDITING PROFESSION

BY

MOGERE B. STELLA

A Project Report Submitted to the School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in International Business Administration

UNITED STATES INTERNATIONAL UNIVERSITY
NAIROBI

SUMMER 2003
STUDENT'S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: [Signature]  Date: 20/10/2003

Stella B. Mogere (ID 263084)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: [Signature]  Date: 28/10/03

Dr. George Achoki

Signed: [Signature]  Date: 30/10/2003

Dean, School of Business

Signed: [Signature]  Date: 22/11/03

Deputy Vice Chancellor, Academic Affairs
ABSTRACT

Independence has always been a concept fundamental to the accounting profession. No matter how competent any auditor may be, his/her opinion on financial statements will be of little value to those who rely on him unless he maintains his independence.

The general objective of the study was to establish the factors limiting the external auditors independence in the auditing profession, while the specific objectives were:
(i) To determine the requirements of the code of ethics with respect to auditor independence;
(ii) To identify the source of the auditor independence problem;
(iii) To establish the factors that would enhance the auditors' independence and;
(iv) To establish how effectively the rules and regulations can be applied to enhance independence.

A structured questionnaire was used to collect primary data to establish factors limiting the external auditor's independence and highlighted rules and regulations that can enhance auditor independence. Secondary data was collected through journals on the internet, and text books on auditing. Analysis of data was done using MS Excel and Statistical Package for Social Scientists (SPSS) and was presented in tables and charts.

The findings of this study revealed that heavy involvement in non-audit services, over-reliance on one client for fees to the extent that it exceeds 15% of the practices gross fee, preparation and audit of the accounts by the same firm, substantial shareholding in the client company leading to a conflict of interest situation, close involvement with the management of the client company, inadequacy of the rules and regulations, lack of confidence in the auditing profession, and lastly corruption are the major factors limiting the external auditors independence.
The study recommended that auditors’ independence may be enhanced by full and frank disclosure to those involved in cases where conflict of interest may arise, endorsing professional ethics while doing their job and for auditors to avoid over-reliance on one client for fees and situations in which they may be tempted to compromise their independence. While it is right that members should provide for audit clients other services beyond performing the audit, care must be taken not to perform executive functions or to make executive decisions, as these are the duties of management. Besides, further research needs to be conducted in the same area by taking samples from different parts of the world in order to establish the worldwide trend.
ACKNOWLEDGEMENT

The completion of this project is an accomplishment that could not have taken place without the contribution of many people. I would like to take this opportunity to thank the members of the School of Business at United States International University for helping me to attain my Masters Degree.

My special thanks go to Dr. George O. Achoki, who supported me through this research project by his guidance, valuable suggestions and patience. I would also like to extend my appreciation to all the participants involved in the data collection. The research could not have been undertaken without the full cooperation of those who shared their valuable experience in interviews and questionnaires.

I am particularly grateful to my friends and relatives. They encouraged me through numerous ways throughout the length of my studies.

This project is dedicated to my mother Mrs. Rebecca Mogere, and sisters, Tiffany and Diana for their perseverance, understanding and support during my long hours of studies away from home, thus missing my attention in my absence.

It is my hope that my sisters will endeavor to achieve higher academic standards in their lives than myself.
DEDICATION

To my dear sisters, whose support and encouragement inspired me to strive for higher goals in life.
# TABLE OF CONTENTS

- Front Matter
  - Title Page
  - Abstract
  - Table of Contents
  - Acknowledgement
  - List of Figures
  - List of Tables
  - Glossary
  - Acronyms

## CHAPTER ONE: INTRODUCTION

1.1 Background

1.2 Problem Statement

1.3 Objectives Of The Study

1.4 Justification Of The Study

1.5 Limitations

1.6 Chapter Summary

## CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

2.2 Origin Of The Auditor Independence Problem
  2.2.1 Independence and the CPA’s Code of Professional Ethics
  2.2.2 The Securities and Exchange Commission and Independence
  2.2.3 The Independent Auditor Controversy
  2.2.4 Ways in which Auditor’s Independence may be compromised
  2.2.5 Applicability of the independence rule
  2.2.6 Solutions on how to strengthen auditor independence

## CHAPTER THREE: METHODOLOGY

3.1 Introduction

3.2 Research Design

3.3 Population and Sample

3.4 Data Collection Methods

3.5 Research Procedures

3.6 Data Analysis Methods

3.7 Chapter Summary
<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 2.1</td>
<td>Effects of relative, business and financial interests on Auditor Independence</td>
<td>19</td>
</tr>
<tr>
<td>Table 4.1</td>
<td>Average tenure of service of directors</td>
<td>23</td>
</tr>
<tr>
<td>Table 4.2</td>
<td>Company’s choice of auditors’</td>
<td>24</td>
</tr>
<tr>
<td>Table 4.3</td>
<td>Length of time in business</td>
<td>25</td>
</tr>
<tr>
<td>Table 4.4</td>
<td>Appointment and Removal of external auditors’</td>
<td>27</td>
</tr>
<tr>
<td>Table 4.5</td>
<td>Employees in the account’s department</td>
<td>27</td>
</tr>
<tr>
<td>Table 4.6</td>
<td>Frequency in recruitment of fresh graduates</td>
<td>28</td>
</tr>
<tr>
<td>Table 4.7</td>
<td>Minimum qualifications necessary to be employed in the accounts department</td>
<td>29</td>
</tr>
<tr>
<td>Table 4.8</td>
<td>Adequacy of the rules and regulations in strengthening auditors’ independence</td>
<td>30</td>
</tr>
<tr>
<td>Table 4.9</td>
<td>Extra mechanisms that need to be put in place in order to ensure adherence</td>
<td>31</td>
</tr>
<tr>
<td>Table 4.10</td>
<td>Confidence in the auditors’ ability to do their work professionally</td>
<td>33</td>
</tr>
<tr>
<td>Table 4.11</td>
<td>Situations where auditors’ compromise their independence</td>
<td>34</td>
</tr>
<tr>
<td>Table 4.12</td>
<td>Reliance on audited financial statements to make financial decisions</td>
<td>36</td>
</tr>
<tr>
<td>Table 4.13</td>
<td>Length of time in business</td>
<td>36</td>
</tr>
<tr>
<td>Table 4.14</td>
<td>Number of auditors’ employed</td>
<td>37</td>
</tr>
<tr>
<td>Table 4.15</td>
<td>Possession of professional qualifications</td>
<td>38</td>
</tr>
<tr>
<td>Table 4.16</td>
<td>Taxation</td>
<td>39</td>
</tr>
<tr>
<td>Table 4.17</td>
<td>Consultation</td>
<td>39</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>PAGES</td>
<td></td>
</tr>
<tr>
<td>--------------------------------------------------------------------------------</td>
<td>-------</td>
<td></td>
</tr>
<tr>
<td>Figure 4.1 – Average tenure of service of directors</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td>Figure 4.2 – Company’s choice of auditors’</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>Figure 4.3 – Length of time in business</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Figure 4.4 – Appointment and removal of external auditors.</td>
<td>27</td>
<td></td>
</tr>
<tr>
<td>Figure 4.5 – Employees</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Figure 4.6 – Frequency in recruitment of fresh graduates</td>
<td>29</td>
<td></td>
</tr>
<tr>
<td>Figure 4.7 – Adequacy of the rules and regulations</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Figure 4.8 – Extra mechanisms that need to be put in</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td>Place in order to ensure adherence</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Figure 4.9- Confidence in the auditor’s ability</td>
<td>34</td>
<td></td>
</tr>
<tr>
<td>to do their work professionally</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Figure 4.10 – Situations where auditors’ Compromise their independence</td>
<td>35</td>
<td></td>
</tr>
<tr>
<td>Figure 4.11 – Length of time in business</td>
<td>37</td>
<td></td>
</tr>
<tr>
<td>Figure 4.12 – Non-audit services carried out</td>
<td>41</td>
<td></td>
</tr>
<tr>
<td>Figure 4.13- Peer audits conducted on major clients</td>
<td>42</td>
<td></td>
</tr>
<tr>
<td>Figure 4.14 – Over-reliance on one customer for fees</td>
<td>43</td>
<td></td>
</tr>
<tr>
<td>Figure 4.15 – Disciplinary measures for cases Of professional misconduct</td>
<td>46</td>
<td></td>
</tr>
<tr>
<td>Figure 4.16 – Factors strengthening the auditors’ independence</td>
<td>48</td>
<td></td>
</tr>
</tbody>
</table>
ACRONYMS

1. GAAP: General Accepted Accounting Principles
2. SEC: Securities and Exchange Commission
3. ICPAK: Institute of Certified Public Accountants in Kenya
4. KAS: Kenya Accounting Standards
5. IAS: International Accounting Standards
6. CMA: Capital Markets Authority
7. CPA: Certified Public Accountants
CHAPTER ONE

1.0 INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The present status of the auditor's report and independent auditing represents the culmination of a century of development. Initially, audits were performed primarily at the request of business owners who wished assurance that their bookkeeping had been accurately handled and that all cash was properly accounted for. With the development of partnerships, audits also became useful in determining the amount of profits to be distributed to the partners. The industrial revolution brought with it large-scale enterprises that needed outside financing to supplement owners' capital in order to permit acquisition of costly machines that had become available. It was at this point, of course, that the independent came to the fore, and that the third parties displaced business owners as the principal beneficiaries of auditing services. (Coomer: 1951).

It appears that the public accountants at the beginning of the century wanted no codification of ethics. The justification was reported to be based on the realization that professional men would, of course, behave with integrity and objectivity and, in fact, would be independent. The early public accountants resisted rules for accounting and auditing; also, while they insisted that professional judgment and the general technical knowledge they possessed would assure proper selection of accounting principles and of auditing procedures. (Written standards and principles were not issued until the late 1930s.) With the rule of the Securities and Exchange Commission (SEC) related to independence, there was introduced sufficient pressure on the profession to ultimately accept an explicit statement about independence. However, there has been, from the early deliberations of the SEC, concern with auditor independence. From time to time, it appears that more attention was devoted to the matter than at other times (Previts: 1998).

The Independence Standards Board is organized in the typically bureaucratic manner that is common in the profession.

From the late 1970s to the recent past, there have been a number of efforts to deal with auditor-related problems. The Public Oversight Board named a group to consider auditor independence
in the mid 1990s after the then chief accountant at the SEC raised serious questions about auditor independence. (Imhoff: 1978, Bedingfield and Loeb: 1970)

The resulting report concluded that there was nothing essentially wrong with the guidance for independence. It now appears that, that conclusion was viable for a very brief period.

The significance of transparent, timely and reliable financial statements and their importance to investor confidence had never been more apparent before the Asian financial crisis. These markets learnt a painful lesson, as investors and other stakeholders including employees, customers, suppliers, local communities and financial institutions panic as a result of unexpected and unquantified bad news. Confidence could easily be damaged by the revelation that an enterprise has followed less than vigorous standards in terms of the amount of quality and relevance of information provided. The fear of the Asian financial crisis being repeated everywhere through the urgency of enforcing a set of internationally recognized standards to ensure information upon which stakeholders base their decision is credible (Previts: 1998).

It now becomes more apparent than ever before, that the delay in recognizing that in fact there has been a problem has culminated to the much auditor independence related problems that the accounting profession is now battling out with. Failure to admit that there was a problem has led to lots of confusion regarding the subject and a lot of unambiguity.

1.2 PROBLEM STATEMENT

For auditors today, independence remains a crucial issue. They are required to demonstrate their objectivity, but despite a well-developed set of statutory regulations and professional rules designed to ensure independence, there has been for the last 20 years, an increasing amount of criticism of their profession. Much of this criticism stems from the changing roles of the professional accountant in society.

The extensive consideration given here to the subject of independence in audit engagements is necessitated by the fact that independence is so difficult to maintain. Independence remains a problem for even the most moral, honest auditor.
The auditor must remain independent of the business whose statements he is examining, and yet that business will normally have engaged the auditor and will pay his fee! In such a situation, the auditor must of necessity watch every step he takes as carefully as if he were on a tight rope. The present auditor is faced with numerous difficulties as he finds it increasingly difficult to maintain independence. Today there are many factors that limit the auditor's independence, and it is up to the auditor to use his judgement and avoid situations in which he might be tempted to compromise his independence: in addition he has to reassure the public that he will avoid exposing himself to such temptation (Abbott: 2001).

In a sense, it appears that the auditors' lack of independence is due to his/her conflict of interest. The auditor must please his client and at the same time he must be certain that his report can be relied upon with complete confidence by third parties who are interested in his client's statements. Needless to say, concern for these third parties must always be foremost.

Exploration of this problem has been acknowledged, but largely ignored by the accounting profession probably because the proposed, "cure appears to be worse than the disease." (Weil:2001). This study aims at investigating the factors that limit auditor independence. The study will focus on aspects or rules and regulations that aim at enhancing the external auditors independence.

### 1.3 OBJECTIVES OF THE STUDY

#### General Objectives Of The Study

The main objective of the study was to establish the factors limiting the external auditors independence in the auditing profession.

#### Specific Objectives Of The Study

The specific objectives of this study were;

1) To determine the requirements of the code of ethics with respect to auditor independence.
2) To identify the source of the auditor independence problem.
3) To establish the factors that would enhance the auditors' independence.
4) To establish how effectively the rules and regulations can be applied to enhance independence.

1.4 JUSTIFICATION OF THE STUDY

The study is important to the external auditors in understanding the users perception of the services they deliver. This may enable the auditors to identify the need for improvement in their service delivery and also in the manner in which they work, that they have to put independence at the top of their priority.

The significance of transparent, timely, reliable and accurate financial statements and their importance to stakeholders’ protection cannot be underestimated (Simunic: 1984). Corporate credibility, through a fragile concept is the foundation upon which all stakeholders base their confidence in the future success of an enterprise.

The study will be of benefit to the following parties:

1.4.1 Stakeholders include suppliers, creditors, financial institutions e.g. banks, insurance companies, and the government. This is important, as this will enable the auditors to identify need for improvement in their service delivery and also in the manner in which they work, that they have to put independence at the top of their priority list.

1.4.2 Clients who may wish to have effective and competent audit service. What they need to look at before engaging an auditor.

1.4.3 Institute of Certified Public Accountants (ICPAK) and other accounting bodies that may find these factors useful in setting of audit guidelines. Having phased out Kenya Accounting Standards (KAS) and introduced International Accounting Standards (IAS), there is need to evaluate the compliance of reporting firms to the set regulations.

1.4.4 Academicians who may wish to carry out further research pertaining to the independence of auditors. A number of future research opportunities are suggested by these findings. Since no study is definitive in its conclusions, similar studies conducted in different parts
of the world and with a varied group of respondents could lead to a better understanding of the issues. Second, different methodologies may be used so as to lead to triangulation and more confidence in the results.

1.4.5 For commercial firms quoted on the Stock Exchange, the Capital Market Authority (CMA) may be able to determine whether there is compliance to the set regulations, thus preventing any capital flights as was experienced in the Asian markets panicked as a result of unexpected, unquantifiable and inadequate financial information.

1.5 LIMITATIONS

The limitations encountered in the course of this study were;
1) Respondents' unwillingness to divulge information in instances where they have been compromised for the sake of securing their jobs and protecting the firms' name.
2) Insufficient funds are likely to affect the scope of the study, because the research will not be able to cover the whole country.

1.6 CHAPTER SUMMARY

In this chapter, the introduction of the study has been done, highlighting the development of auditing profession, importance of auditor independence in the auditing profession and how important it is for auditors' to maintain their independence.
It also highlights how the study will be conducted with a view to achieving the research objectives.
CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the literature related to the factors limiting the external auditors’ independence. This chapter first highlights the origin of the auditor independence problem and touches on the rules and regulations present on independence of the auditor. It then finally looks at situations in which auditor independence may be compromised and provides solutions on how to strengthen their independence.

Prior research has examined the impact of various factors on the perception of users and auditors regarding auditor independence. Over two decades of research on auditor independence has shown that users are generally satisfied with the independence of auditors’. Yet, over the years a significant minority has identified certain factors that have impacted their assessment of auditor independence negatively. These factors have been identified in the section below and have been included in the current study.

2.2 Origin of Auditor Independence Problem

Given that the management of the enterprise being audited is the client, that management holds the dual position of being the employer and the group whose performance is being evaluated and reported on is in a conflict-of-interest position, how can she credibly claim to be independent of the claim to put the interests of the public before those of himself or the firm?

Independence remains a problem for even the most moral, honest auditor. Despite the auditor’s best efforts to place the external users’ interests above the client’s and to maintain objectivity, they may be unable to overcome cognitive or psychological biases that make them arrive at marginal decisions in the client’s favor (Simunic : 1984).

In a sense, it appears that the independent auditor’s difficulties arise from an attempt to serve two masters. The auditor must please his client and at the same time he must be certain that his report can be relied upon with complete confidence by third parties who are interested in his client’s statements. Needless to say, concern for these third parties must always be foremost. Should this
group lose confidence in the auditor’s reports, the auditor is certain to begin losing clients, for the client engages the independent auditor primarily to satisfy these third parties.

2.2.1 Independence and the CPA’s Code of Professional Ethics
In as much as a loss of faith in one member of the profession reflects also on the profession as a whole, the profession has taken steps to induce practitioners to remain independent and to strengthen public confidence in the auditor’s independence. The principal approach to the problem has been through the promulgation of a code of ethics by the American Institute of Certified Public Accountants. The resulting code is of course, enforceable only against those CPA’s who voluntarily hold membership in the Institute, but the code serves as a guide for the entire public accounting profession (Pratt: 1983). The various states societies of Certified Public accountants have generally patterned their codes after that of the Institute, and in those states where the state board of accountancy is empowered to formulate and enforce rules of ethical conduct, the Institute rules have also been used as a guide.

These rules cannot, obviously, fully guarantee independence, because independence is primarily a state of mind. The rules do, however, compel the auditor to avoid situations in which he might be tempted to compromise his independence; in addition, they reassure the public that the auditor will avoid exposing himself to such temptation. The following rules are directly concerned with fostering and preserving the auditor’s independence (Stettler: 1956).

*Rule 1.01*: Requires a member to be independent of a client in an opinion is expressed on the client’s financial statements. Any direct financial interest or material indirect financial interest is prohibited, as is any relationship to the client, such as promoter, underwriter, voting trustee, director, officer, or key employee. This rule, which became effective in January 1, 1964, represents an extension of as prior rule that referred only to the prohibition of a material financial interest, and brings the profession’s position on independence closer to that of the Security Exchange Commission, as expressed in its rules.

*Rule 1.04*: Prohibits fee arrangements in which the fee is contingent upon the findings or results of the service. The rule specifically accepts matters involving taxes. The accountant may serve as his client’s advocate in tax matters because the responsibility for the ultimate decision on tax
matters because the responsibility for the ultimate decision on tax matters rests with the taxing authority.

Rule 2.02: Holds a member to be guilty of an act discreditable to the profession if in expressing an opinion on financial statements he fails to disclose any known omission or misstatement of significant information in the statements, or fails to conduct an examination adequate to support his opinion. Such acts would carry a strong presumption that the individual was not acting independently.

Rule 4.04: Prohibits engagement in any business or occupation conjointly with public accounting that would be incompatible with public accounting. Thereby excluded on the basis of detracting from the dignity of the profession would be such activities as auctioneer or door-to-door solicitor, and excluded on the basis of jeopardizing the accountant’s independence would be such occupations as stockbroker or investment counsellor.

2.2.2 The Securities and Exchange Commission and Independence

The mistaken idea is quite widely held that the Securities Act of 1933 and Securities Exchange Act of 1934 were intended to protect investors from losses resulting from doubtful investments. Actually, there is no intent in this act to protect investors from their own poor judgment, and any such attempt would be completely inconsistent with the operation of a free economic society (Elliot: 1979). The primary purpose of this act is to help assure investors that they have reliable information on which to base their investment decisions. This objective is accomplished by putting in place requirements that companies planning to sell securities in interstate commerce should file registration statements with the SEC, and requiring companies listed on national securities exchange, as well as other certain companies exceeding a specified size and number of stockholders, to file annual reports with the commission. The financial statements included in these filings must be accompanied by the report of an independent public accountant (Morison: 1971).

Although the Commission carefully reviews such statements for adequate and conformance with its rules and regulations, it relies on the opinion of the independent public accountant retained by
the registered company for assurance of the validity and fairness of the statements. The responsibility for the adequacy of the examinations of such statements has wisely been allowed to remain with the individual accountants and their profession, but the SEC does insist firmly on the independence of the public accountant in each case. The pertinent paragraphs of Rule 2.01 of the Commission’s Regulation S-X state:

2.2.2.1 The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent. For example, a accountant will be considered not independent with respect to any person or any of its parents or subsidiaries in whom he has, or had during the period of report, any direct financial interest or any material indirect financial interest; or with whom he is, or was during such period, connected as a promoter, underwriter, voting trustee, director, officer or employee.

2.2.2.2 In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission.

Findings by the Commission of lack of independence in specific instances are summarized in accounting Series Release no. 47 and No. 81. The concern of the Commission over the matter of independence may be judged from the fineness of the line drawn in holding the public accountant to be not independent in the following instances;

1) More than 1 percent of the accountant’s personal fortune was invested in the capital stock of his client.

2) The accountant was indemnified by his client against all losses, claims, and damages arising out of his certification of the client’s statements.

3) Shares of the client’s stock were pledged to guarantee payment of the accountant’s fee, and the accountant was granted an option to purchase the pledged shares at the market price at the date of the option.
4) A partner of an accounting firm was serving on the board of directors of a registrant, but he did not participate in any way in the accounting firm's audit of the registrant.

5) The son of a partner of an accounting firm that certified the financial statements of a registrant was serving as assistant treasurer and chief accountant of the registrant.

6) A senior staff member of an accounting firm had supervised the audit of the registrant and was appointed as controller to serve while the regular controller was in the armed forces. The employee remained on the staff of the accounting firm but relinquished all responsibility for the audit of the registrant and did no work in connection with the audit.

7) An accountant took an option for shares of his client's common stock in settlement of his fee.

8) The wife of an accountant had a 47.5 percent interest in one of the three principal underwriters of a proposed issue by the registrant.

The SEC has held that an accountant cannot do bookkeeping work for a client filing reports with the Commission if such work involves making decisions at a management level, but mere posting of transactions journalized by client employees will not disqualify the accountant for loss of independence (Reynolds: 2001).

2.2.3 The Independent Auditor Controversy

As owners, shareholders consider auditors to have knowledge and expertise that fits them for directing the affairs of companies. (Beck: 1973) brings out clearly the auditors responsibility in the following statement.

"But I doubt whether many (or any) auditors realise how much closer their role is, in the eyes of the shareholders, to that of a policeman than is to that of a reporter on a state of affairs." (Weil: 2001).

The professional body of auditors must therefore decide for itself, how best to perform the role that society assigns to it as a result of the place the profession has in total socio-economic order. Failure to perform the role is almost certain to bring action from society eventually; there will be either attempts to force the professional group to assume the full role or a removal and re-
assignment of part of the role to other social functionaries such as legal firms or engineering consultants (Willingham: 1986).

An auditor is not however bound to be a detective or as was said to approach his work with suspicion, or with the forgone conclusion that there is something wrong (Watts: 1977). An auditor must be honest, that is, he must take reasonable care and skill before he believes that what he certifies is true. This would ideally among other things tend to set up ground substance for the choice of an auditor.

For the purpose of this study, an external auditor is a person who expresses his opinion to whether the financial statements presents the financial position, results of operation and changes in financial position in conformity with General Accepted Accounting Principles (GAAP).

Thus the external auditors opinion provides both internal and external users with input to make reasoned, logical and informed decisions about a variety of financial matters, including business entity's earning performance and economic vulnerability (Manson: 1991). External auditors conduct opinion audit, and re-compensated directly by the organization audited. Thus an external auditor performs an external audit, which is a systematic process beginning with a client's request for audit services and culminates in attestation. Firms normally demand external auditing due to the managers and investors efforts to control their conflicts of interest (Watts: 1977).

2.2.4 Ways In Which Auditors Independence May Be Compromised

There can be no doubt in Professor David Abbott's words, "an auditor is virtually useless as an auditor if he is not independent."

It is logically evident, that you cannot expect one person to check the work of another if he depends on that in some way. But the problem comes in deciding what can and what cannot make the auditor dependent. Nor is the fact of independence alone sufficient for it is important that the auditor shall be seen to be independent by the people who are relying upon him (Toeh: 1993). Without such evidence, confidence fails and the auditor's role is diminished. We can identify a number of ways in which the auditors' independence may be compromised:
2.2.4.1 Close involvement with the management of the company on a business or personal level. This possibility is largely prevented by the provisions of company law; the two loopholes mentioned below should be noted (Manson: 1991)

One is the fact that certain categories of people are specifically excluded from accepting office as public auditors, and these include:

a) A body corporate;

b) An officer or servant of the company;

c) A partner or employee of an officer or servant of the company.

The body corporate (or company) is excluded on the grounds that the audit is a personal service, so it would be inappropriate for one 'legal person' to oversee the acts of another. Officers and servants together with their partners and employees are excluded for the obvious reason of maintaining the auditor's all-important independence.

2.2.4.2 Substantial shareholding in the client company; there could be the risk that auditors may concur with directors wishes to adjust profits upwards, in order to benefit their own interests. Equally as dangerous, the auditors could be accused of so concurring, even if this was not in fact the case. A side issue often raised in this connection is that auditors, directors and others with substantial shareholdings and inside knowledge may be accused of 'insider dealings' on the stock Exchange (Pratt: 1983).

2.2.4.3 Preparation and audit of the accounts by the same firm. It is hard to see how one person can objectively and independently check the work that he himself has prepared. Indeed logically it cannot be so. But this problem is more common in small firms and small limited companies. In these companies, there is often no need for an independent check on the management on behalf of the shareholders, in that the two are often the same.

2.2.4.4 Heavy involvement in other work, such as management consultancy, taxation services, system design, secretarial work, financial advice etc. may mean that the fees for 'other services' may be substantially higher than the audit fee itself. To lose the audit would probably be to lose his work too, so substantial financial pressure could be placed upon
auditors to concur with director's wishes (Whittington: 1995). And there is the further
danger that the auditors may become, or may appear to become too involved in the
making or formulating of management decisions for them to remain objective.

2.2.4.5 Similar financial pressure could be imposed if one client represented a significant
proportion of the audit firms' total fees. This is perhaps not so important with the bigger
firms as the loss of one, even large, audit may not be significant- 'you win some, you lose
some.' But it could well be very significant to a medium sized firm struggling for survival
(Reynolds: 2001). And this is an area where considerable concern has been expressed.

2.2.4.6 More subtle is the problem the auditor faces with a client in a difficult financial situation.
A qualification may be required to his report, even a qualification to the effect that the
company is no longer a going concern.
Such a qualification would of course give the company no further hope of survival. And
this almost certainly would not be in the shareholders' interests, which the auditor is
appointed to serve. The creditors may ultimately benefit from such a qualification if it
results in an orderly winding up; but company law at the present time does not require the
accounts to show a true and fair view to the creditors (Reimer: 1971). Only the auditor's
integrity and levelheaded judgment can solve this very tricky problem.

2.2.4.7 Finally, one can point to the whole system itself whereby the auditors are effectively, if
not in law, paid and appointed by the directors' and ask if there can ever be real and total
independence. We who pays the piper calls the tune. This leads logically to the almost
heretical suggestion of a nationalized auditing profession.

2.2.5 Applicability of the Independence Rule

The independence rule does not apply to all services performed by public accountants.
CPAs perform a host of services in which the client is the major beneficiary, such as
management consulting, tax, and accounting services. In performing these services, the
CPAs are not attesting to information for third parties, and observance of the
independence rule is not required (Pany: 1995). Of course, the independence rule applies
to auditing, but it also applies to all other attestation services, such as reviews of financial statements, examination of financial forecasts, and the application of agreed-upon procedures to financial information.

2.2.6 Solutions On how to Strengthen Auditor Independence

The following solutions that have been put forward to combat some of these problems. In early 1990 the SEC published a discussion document on professional independence, and revised Ethical Guidelines were introduced on 1st January 1992. The following is a summary of the major provisions:

2.2.6.1 Fees

Recurring fees from one source should not exceed 15 per cent of the gross fee of the practice.

2.2.6.2 Personal Relationships

These of partners or staff with client officers or employees, either by blood, marriage or close friendships- could prejudice independence. This applies particularly in the case of any business relationship, and may also apply in the situation where one member of staff works on the audit for many years (Carmichael: 1975).

2.2.6.3 Financial Involvement

This may arise in several ways that can affect objectivity. The following situations should be avoided:

a) Shareholdings

A practice should ensure that it does not have as an audit client a company in which a partner in the practice, the spouse or minor child of such a partner is the beneficial holder of shares, nor should it employ on the audit any member of staff who is the beneficial holder of such shares (Morison: 1971). Where a practice is asked to report other than in the capacity as auditor, no partner or employee engaged on the assignment should have shareholding as above. There are certain minor exceptions to allow time for the disposal
of such shares acquired involuntarily through inheritance, and in relation to such shares held through unit or investment trusts. Savings in client building societies are only prohibited if they represent a significant amount in relation to the saver.

b) **Trusts**
A practice should not have as an audit client, a public company if a partner in the practice, or the spouse of a partner, is a trustee of a trust holding shares in that company and the holding is in excess of 10% of the issued share capital of the company or the total assets comprised in the trust. (Reimer: 1971). A number of detailed additional provisions also apply.

c) **Loans**
Neither the practice, nor partners, spouses, or minor children of partners, should make or receive loans to or from a client company.

d) **Goods and services**
Goods and services from clients should not be accepted on more favorable terms than would normally be granted to employees of the client. Undue hospitality should be guarded against.

e) **Commission**
Where the practice will earn a commission from a client as a result of his acting upon advice given, care must be taken that the advice is in the best interests of the client and that the commission is disclosed to him (Beck: 1973). (Note that the UEC's 1989 Independence statement says that 'in no circumstance' should a public accountant accept such a commission. A fee should be charged on a proper professional basis, and the accountant should have been no financial interest in its independence.
2.2.6.4 Conflicts of Interest

In cases where conflict of interest may arise, there could be full and frank disclosure to those involved, coupled with an action necessary to discharge from one both positions, the conflicting interests of which have occasioned the difficulty.

2.2.6.5 Provision of other Services to Audit Clients

Whilst it is right that members should provide for audit clients other services beyond performing the audit, nevertheless, care must be taken not to perform executive functions or to make executive decisions. These are the duties of management. In particular, members should beware lest in providing such services, they drift into a situation in which they step across the borderline of what is proper (Carmichael: 1975).

2.2.6.6 Preparation of Accounting Records

A practice should not participate in the preparation of the accounting records of a public company, except in exceptional circumstances.

In the case of a private company, audit clients, it is frequently necessary to provide a much fuller service than would be appropriate in the case of a public company audit client and this may include participation in the preparation of accounting records (Abott: 2001).

In all cases in which a practice is concerned in the preparation of accounting records of an audit client, particular care must be taken to ensure that the client accepts full responsibility for such records and that objectivity in carrying out the audit is not impaired.

2.2.6.7 Current Appointment in a Company Reported On

A practice wherever it may be situated, should not report on a company, even if the law of the country in which the company is registered would so permit, if a partner or employee of the practice is an employee of the company (Pany: 1995). Nor should a practice report on company if a company is associated with the practice fills the appointment of secretary to the client. It should be particularly noted that this guidance is
applicable to members, whether they are within or without the United Kingdom and whether they are in practice or not.

2.2.6.8 Previous Appointment in a Company Reported On

No one should personally take part in the exercise of the reporting function on a company if he has, during the period upon which the report is able to be made on at any time in the two years prior to the first day thereof, been an officer (other than auditor) or employee of the company (Abbott: 2001).

2.2.6.9 Liquidation Following Receivership

Where a partner is an employee of a company, no partner in or employee of the practice should accept appointment as liquidator of the Bank.

2.2.7.0 Liquidation Generally

Where a practice or a partner in or an employee of a practice has had a continuing professional relationship with a company, no partner or employee of the practice should accept appointment as liquidator of the company, if his company is insolvent (Morison: 1971). When a company is solvent, such appointment should not be accepted without careful consideration being given to the implications of acceptance in that particular case.

2.2.7.1 Receivership

Where a practice or a partner in or an employee of a practice has, or during the previous 2 years has had a continuing professional relationship with a company, no partner in or employee of the practice should accept appointment as receiver or manager of that company (Pany: 1995).

2.2.7.2 Audit Following Receivership

Where a partner in or an employee of a practice has been receiver of any of the assets of a company, neither the practice nor any partner in or employee of the practice should accept appointment as auditor of the company, or of any company which was under control of the receiver, for any accounting period during which the receiver acted or exercised control (Reynolds: 2001).
2.2.7.3 New Clients

Whenever a practice is asked to accept an appointment, consideration will need to be given to whether acceptance might give rise to a situation in which independence may be compromised whether by a prospective conflict of interest or otherwise (Morison: 1971). All reasonable steps should be taken to establish that acceptance is unlikely to threaten independence.
## Table 2 EFFECTS OF RELATIVE, BUSINESS AND FINANCIAL INTERESTS ON AUDITOR INDEPENDENCE

<table>
<thead>
<tr>
<th>RELATIVE</th>
<th>GENERAL RULE</th>
<th>MAJOR EXCEPTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spouse and dependants</td>
<td>Independence rules same as for CPA</td>
<td>Independence may not be impaired if a relative is an employee of a client as long as the relative is not in a position of significant influence, and is not in an audit sensitive position.</td>
</tr>
<tr>
<td>Close Relative</td>
<td>Independence impaired when a close relative has 1) A position of significant influence 2) An audit sensitive position 3) A material financial interest of which the CPA is aware</td>
<td>In situation (1), partners may be transferred to another office, and other professional staff must not be allowed to work on the engagement; in situation (2) or staff must not be allowed to work on the engagement.</td>
</tr>
<tr>
<td>Other Relatives</td>
<td>Normally, no effect on independence</td>
<td>Independence may be impaired when circumstances (e.g. business and personal relationships) would lead to a reasonable person to question the CPA’s independence</td>
</tr>
</tbody>
</table>

This table applies to (1) all partners in the firm, (2) all managerial employees assigned to an office that significantly participates in the engagement, and (3) all professional staff personally participating in the engagement. (Pratt: 1983)
CHAPTER THREE: RESEARCH METHODOLOGY

3.3.1 Introduction

This chapter highlights the methods and procedures the research had adopted in carrying out this study. It has clearly defined the research design, population and sample, data collection methods, research procedures, data analysis methods and lastly the chapter summary.

3.3.2 Research Design

The study was descriptive in nature. This is because descriptive research design provides data about the population being studied. This descriptive type of research seeks to describe the state of affairs, as they exist at a particular time. It provides a systematic description that is factual and accurate as possible hence this has fitted well with my research problem.

The research is a statistical study. This method has captured the population’s characteristics by making inferences from sample characteristics. Generalizations about the findings have been presented based on the sample studied.

3.3.3 Population and Sample

3.3.3.1 Population

The participants in the study included auditing firms in Nairobi and the users of accounting information, which included employees of these firms, management, creditors, suppliers and investors.

The research was restricted to Nairobi as this is where most of the auditing firms are situated and collection of data goes back fifty years.
3.3.3.2 Sample Selection

A list of auditing firms in Nairobi was collected from the postal directory. The subjects utilized for this study were the auditors and users of accounting information i.e. third parties. For the auditors, the research was stratified sampling technique to identify the subjects. Simunic (1984) argued that stratified sampling provides one way of obtaining a representative sample: therefore it ensures different groups of a population are adequately represented in the sample so as to increase the level of accuracy. This method provides a more representative sample than strictly random sampling does.

The individuals were selected from within the population of interest since they possessed attributes not shared by all individuals in the population. In all, nine auditing firms participated in the research, out of a total of twelve contacted for the study, while nine users of accounting information from a total of fourteen responded. Eighteen questionnaires were collected, out of twenty-six which were sent out, to provide information for this study.

3.3.4 Data Collection Methods

Both primary and secondary data was used. Primary data was collected through field surveys and personal interviews, to get an accurate and current understanding of the factors limiting the auditors’ independence. Personal interviews were used to pre-test the two sets of structured questionnaire that were developed to administer the survey. The questions were developed from the relevant literature from the literature review section.

Secondary data was collected through journals and textbooks on auditing. Since much study has not been done on auditors’ independence, most literature review was from textbooks.
3.3.5 Research Procedures

3.3.5.1 Administering the Questionnaire and Interviews

The research instruments were administered and responses collected by the researcher. The questionnaires were distributed to the different organizations under study and collected after 2-3 weeks. Questionnaire packages include a letter of introduction and one questionnaire. Each person was asked to fill the questionnaire to his or her best knowledge. The questionnaire was designed to assure complete anonymity. One questionnaire was sent to each organization and a designated pick and drop point was identified in each organization.

3.3.6 Data Analysis Methods

The data used in this study was descriptive in nature. Data analysis was done by employing the marketing research software SPSS. This was used to generate reports through cross tabulations percentages and measures of central tendency. Graphs, tables, and pie charts were used to interpret and derive conclusions from the analyzed data to relate to the research questions and objectives.

3.3.7 Chapter Summary

This chapter explains the research design, gives and introduction to the population sample as well as the computation of the sample size. The methods of data collection and analysis are also presented in the chapter. The data used in this study was descriptive in nature, and was analysed using tables, graphs, charts and summary measures such as averages, standard deviation and Percentages. It dealt with, making decisions, inferences, predictions and forecasts about populations based on results obtained from samples.
CHAPTER FOUR: RESULTS AND FINDINGS

4.1 Introduction

This chapter presents detailed research findings of the study. The data collected has been
organized according to the research questions, used for this study. The chapter is organized into
three sections, the first section looks at demographic data, the second section analyses the users
of accounting information, while the third section gives an in depth analysis of the auditing
firms.

4.2 Profile of Respondents

The respondents drawn from this study were classified on the basis of, average tenure of service
of directors, length of time in business and choice of company’s auditors.
Two sets of questionnaires were used in this study;

- For the users of accounting information
- For Auditing firms

4.2.1 Analysis of Users of Accounting Information

4.2.2 Average Tenure of Service of Directors

The study sought to find out the length of time served by directors in their respective
organizations. Out of the employees interviewed in various organizations, 88.9% had directors in
their firms having worked for between 1-5 years, while only 11.1% had directors in their firms
having worked for between 5-10 years.
The Table below illustrates the above;

Table 4.1 Average Tenure of Service of Directors

<table>
<thead>
<tr>
<th>Years</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-5 years</td>
<td>8</td>
<td>88.9%</td>
</tr>
<tr>
<td>5-10 years</td>
<td>1</td>
<td>11.1%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0%</td>
</tr>
</tbody>
</table>
From the table and pie chart above, majority for the directors have served in the various firms for between 1-5 years.

This therefore indicates that directors are regularly appointed.

4.2.3 The Company’s Auditors

The opinion of the respondents was sought regarding their preference of auditors. The auditors here included Deloitte and touche, Price Waterhouse Coopers, KPMG among others.

The results are indicated below.

Table 4.2 Company’s choice of auditors

<table>
<thead>
<tr>
<th>Auditors</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deloitte and touche</td>
<td>4</td>
<td>44.4 %</td>
</tr>
<tr>
<td>Price Waterhouse Coopers</td>
<td>1</td>
<td>11.1 %</td>
</tr>
<tr>
<td>KPMG</td>
<td>1</td>
<td>11.1 %</td>
</tr>
<tr>
<td>Auditor General</td>
<td>1</td>
<td>11.1 %</td>
</tr>
<tr>
<td>Ernst and Young</td>
<td>1</td>
<td>11.1 %</td>
</tr>
<tr>
<td>Kassim Lakha</td>
<td>1</td>
<td>11.1 %</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>99.9 %</td>
</tr>
</tbody>
</table>
Figure 4.2 Company’s choice of auditors

From the above pie chart it can be deduced that most of the firms (45 percent) preferred Deloitte and touché as their auditor. Only 11.1% of the respondents preferred, Price Waterhouse Coopers, KPMG, Kassim Lakha, Ernst and Young and the Auditor General in that order.

4.2.4 Length of Time in Business

From the analysis of the table and pie chart below, it is evident that most of the auditors (55.6%) had served for a period of between 5 to 10 years, while 33.3% of the auditors had served for between 1 to 5 years, with only 11% having served in the companies for more than 10 years.

Table 4.3 Length of Time in Business

<table>
<thead>
<tr>
<th>Years</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 5 years</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td>5 to 10 years</td>
<td>5</td>
<td>55.6</td>
</tr>
<tr>
<td>More than 10 years</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Figure 4.3 Length of Time in business

The above table and pie chart can be illustrated more clearly in the graph below.

It can therefore be deduced from the above that most companies retain their auditors for 5 to 10 years, while very few companies let their auditors hold office for more than 10 years. This is important as the auditor does not retain an assignment long enough to get too familiar and comfortable enough to compromise his independence.
4.2.5 Appointment and Removal of External Auditors

Table 4.4 Appointment and Removal of External Auditors

From the table below it can be concluded that in most firms i.e. (66.7%) it is the shareholders who are instrumental in appointing or removing auditors, while in only 33.3% of the firms, it is the directors who appoint or remove auditors.

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directors</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td>Shareholders</td>
<td>6</td>
<td>66.7</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Figure 4.4 Appointment and Removal of External Auditors

4.2.6 Employees in the Accounts Department

The research sought to find out the number of employees employed in the accounts department.

Table 4.5 Employees in the Accounts Department

<table>
<thead>
<tr>
<th>Employees</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 30</td>
<td>6</td>
<td>66.7</td>
</tr>
<tr>
<td>Above 30</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>
In the sample studied, 66.7% of the companies had between 1 to 30 employees employed in their accounts department, whereas 33.3% of the companies under study had over 30 employees in their accounts department.

4.2.7 Frequency in Recruitment of Fresh Graduates

The respondents were asked to state how frequent fresh graduates were recruited in various organizations.

Table 4.6 Frequency in Recruitment of Fresh Graduates

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yearly</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>Every five years</td>
<td>2</td>
<td>22.2</td>
</tr>
<tr>
<td>When need arises</td>
<td>6</td>
<td>66.7</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The results from the above table indicate that out of all the companies studied, 66.7% recruit fresh graduates when need arises, while 22.2% recruit every five years, with only 11.1% recruiting yearly.
Figure 4.6 Frequency in Recruitment of Fresh Graduates

4.2.8 Minimum Qualifications necessary to be employed in the Accounts Department

The sample studied were asked to state the minimum qualifications they thought were necessary to be employed in the accounts department.

Table 4.7 Minimum Qualifications necessary to be employed in the accounts department

<table>
<thead>
<tr>
<th>Qualifications</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree and Professional course</td>
<td>2</td>
<td>22.2</td>
</tr>
<tr>
<td>Accounting Qualification based on position</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>Accounting Technician Certificate</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>CPA Part 2 and relevant degree</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>Full CPA</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>Full CPA and business related degree</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>For Accounts clerk- Accounting Technician’s course</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>For accountant- Degree or Full CPA</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>High School Certificate</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>99.9</td>
</tr>
</tbody>
</table>

The study sought to find out the minimum qualifications for one to be employed in the accounts department. Most of the companies studied (88.9%) insist on professional qualifications (CPA/ACCA), whereas only 11.1% require a high school certificate.
4.2.9 Adequacy of the Rules and Regulations in Strengthening Auditors’ Independence

The sample studied was asked to state how adequate they thought the rules and regulations were in strengthening the auditors’ independence.

Table 4.8 Adequacy of the Rules and Regulations in Strengthening Auditors’ Independence

<table>
<thead>
<tr>
<th>Response</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>4</td>
<td>44.4</td>
</tr>
<tr>
<td>No</td>
<td>5</td>
<td>55.6</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Figure 4.7 Adequacy of the Rules and Regulations in Strengthening Auditors’ Independence

In this study, the respondents were asked whether they find the rules and regulations present, adequate enough to strengthen the auditors independence.

A great number of the respondents (55.6%) in the study were not satisfied with the rules and regulations put in place in strengthening the auditor’s independence, while 44.4% felt that the rules and regulations were adequate.
Further analysis in the table and graph below highlights the extra mechanisms that the 55.6% of those interviewed feel should be put in place in order of preference so as to ensure adherence.

4.3 Extra Mechanisms that need to be put in place in order to ensure adherence

Table 4.9 Extra Mechanisms that need to be put in place in order to ensure adherence

<table>
<thead>
<tr>
<th>Code</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
<th>G</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>3</td>
<td>7</td>
<td>5</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>7</td>
<td>5</td>
<td>4</td>
<td>6</td>
<td>3</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>1</td>
<td>3</td>
<td>4</td>
<td>2</td>
<td>5</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>4</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>5</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Average</td>
<td>12.5</td>
<td>12.5</td>
<td>13</td>
<td>9.5</td>
<td>9.5</td>
<td>6.5</td>
<td>7</td>
</tr>
</tbody>
</table>

The above table indicates the extra mechanisms that need to be put in place in order to ensure adherence, in order of importance with 6.5 being the lowest score and 13 rated as the highest.

Establishing rules that an accounting firm would not be independent if certain members of management of that issuer had been members of the accounting firm’s audit engagement team within the one-year period preceding the commencement of audit procedures was rated the highest with an average score of 13 points as the most important mechanism that should be put in place to ensure adherence.

Revision of the rules related to non-audit services, and rotation of auditors were rated as the second most important mechanisms that ensure adherence, having an average score of 12.5 points each.

Establishing rules that prohibit payment of compensation to the audit partner based on the partner procuring non-audit engagements, and requiring that the auditor report certain matters to the issuer’s audit committee, were rated as the third most important factors in ensuring adherence of rules and regulations present, and had an average score of 9.5 points each.
Requiring that the issuer’s audit committee pre-approves all audit and non-audit services provided to the issuer by the auditor and, requiring disclosures to investors on information related to audit and non-audit services, provided by, and fees paid to the auditor were ranked as the least important factors that can ensure adherence, with the former having a score of 6.5 points and the latter having an average score of 7 points.

The table above is clearly illustrated in the graph below.

**Figure 4.8 Extra mechanisms that need to be put in place in order to ensure adherence**

![Bar chart showing mechanisms used to strengthen auditors independence]

**Key**

A – Revise the rules related to the non-audit services that if provided to an audit client would impair an accounting firm’s independence;

B – Require that certain partners on the audit engagement: team rotate after no more than 5 or 7 consecutive years, depending on the partner’s involvement in the audit, except that certain small accounting firms may be exempt from this requirement;

C - Establish rules that an accounting firm would not be independent if certain members of management of that issuer had been members of the accounting firm’s audit engagement team within the one-year period preceding the commencement of audit procedures;
D - Establish rules that an accountant would not be independent from an audit client if any “audit partner” received compensation based on the partner procuring engagements with that client for services other than audit, review and attest services;

E - Require that the auditor report certain matters to the issuer’s audit committee, including “critical” accounting policies used by the issuer;

F - Require the issuer’s audit committee to pre-approve all audit and non-audit services provided to the issuer by the auditor; and

G - Require disclosures to investors of information related to audit and non-audit services provided by, and fees paid to, the auditor.

4.3.1 Confidence in Auditor’s ability to do their work professionally

An assessment was made on the confidence users of accounting information have in the auditors’ ability to perform their work professionally. The results in the table below show that 66.7% of the respondents had confidence in the auditors’ ability to do their work professionally. Thirty-three (33.3)% were not confident in the auditors’ ability to do their work professionally. This they argued was because of the level of audit fees together with directors’ strong influence, which tended to limit the auditors’ professionalism and independence. They also felt that there was an existing culture of corruption in all sectors auditors included.

The table and pie chart below, clearly illustrate the above point.

Table 4.10 Confidence in the auditor’s ability to do their work professionally

<table>
<thead>
<tr>
<th>Response</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>6</td>
<td>66.7</td>
</tr>
<tr>
<td>No</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Fig 4.9 Confidence in the auditor’s ability to do their work professionally

4.3.2 Situations where Auditors compromise their independence

An assessment was made of the presence of situations whereby the auditors’ independence was compromised. The table below indicates the response.

Table 4.11 Situations where auditors compromise their independence

<table>
<thead>
<tr>
<th>Response</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>4</td>
<td>44.4</td>
</tr>
<tr>
<td>No</td>
<td>5</td>
<td>55.5</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>99.9</td>
</tr>
</tbody>
</table>
The pie chart below gives the results in a pictorial form;

**Figure 4.10 Situations where auditors compromise their independence**

From the results, 55.5% of the respondents experienced situations where auditors' compromised their independence, as opposed to 44.4% who had not come across similar situations. Those who had experienced the above tendencies, were of the view that auditors independence was compromised by audit fees, in the sense that, large firms which pay huge audit fees tend to influence their auditors to accept their view as regards particular accounting treatment and disclosures. This the auditors do in an attempt to continue maintaining their client's and the monies received from such clients in order to sustain their organizations.

**4.3.3 Reliance on Audited Financial Statements to make Investment Decisions**

An attempt was made to find out whether users of accounting information totally rely on audited financial statements to make investment or financial decisions. The results were as follows;
Table 4.12 Reliance on audited financial statements to make investment or financial decisions

<table>
<thead>
<tr>
<th>Response</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>No</td>
<td>8</td>
<td>88.9</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the above table, most respondents (88.9%) do not totally rely on audited financial statements to make investment or financial decisions, while only a mere 11.1% totally rely on audited financial statements to make decisions.

Majority of the respondents did not just limit themselves to relying on audited financial statements but preferred seeking the opinion of financial consultants, and studying the share prices of company’s together with its track record.

Relying totally on audited financial statements was considered too much of a gamble preferred to diversify their risk.

4.2.1b ANALYSIS OF AUDITING FIRMS

4.3.4 Length of Time in Business

The study sought to investigate how long the respondents had been in business.

The table below gives a further illustration:

Table 4.13 Length of time in business

<table>
<thead>
<tr>
<th>Period</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 5 years</td>
<td>2</td>
<td>22.2</td>
</tr>
<tr>
<td>10 years and above</td>
<td>6</td>
<td>66.7</td>
</tr>
<tr>
<td>Over 100 years</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the above table it can be deduced that 66.7% of the respondents sampled have been in business for 10 years and above, while 22.2% have operated for 2 years, with the least (11.1%) having operated for over 100 years.
4.3.5 Number of Auditors Employed that Are professionally Qualified

Based on the table below we are able to deduce that, a large proportion (44.4%) of the respondents, had between one and ten auditors employed in their firms, while 33.3% had between thirty one and a hundred auditors, while only 22.2% of the respondents had between eleven and thirty auditors in their firms.

It can therefore be deduced from the findings that there are smaller firms than bigger firms only having between one and ten auditors.

<table>
<thead>
<tr>
<th>Number</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 10</td>
<td>4</td>
<td>44.4</td>
</tr>
<tr>
<td>11 to 30</td>
<td>2</td>
<td>22.2</td>
</tr>
<tr>
<td>31 to 100</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>99.9</td>
</tr>
</tbody>
</table>

Respondents were then asked to state which of them were professionally qualified (CPA K) or full ACCA.
Table 4.15 Possession of professional qualifications

<table>
<thead>
<tr>
<th>Professional Qualifications</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPA (K)</td>
<td>234</td>
<td>73.8</td>
</tr>
<tr>
<td>Non CPA (K)</td>
<td>83</td>
<td>26.2</td>
</tr>
<tr>
<td>TOTAL</td>
<td>317</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the above table, most respondents (73.8%) had most of the staff having professional qualifications, while the remaining 26.2% were either pursuing accounting qualifications with a view to attaining full qualifications.

Those who did not have full qualifications were mostly audit trainees who were still receiving training on the job or had just been enrolled.

4.3.6 Checks on Audit Assignments

The study sought to find out how the respondents check whether audit assignments have been properly conducted by their staff.

There was a general consensus on the carrying out of an elaborate audit review by the respective managers in charge of the audit at various levels, and further culminating with the partner in charge of the audit carrying out his/her own separate review. Consequently, an independent review is carried out on the whole audit team by their peer audit firms.

From the findings, it was established that large multinational firms tended to rely on their parent companies that also carried out ‘cold’ reviews on audit work performed by them.

4.3.7 Other Non-Audit Services Offered

The respondents were asked to highlight the number of non-audit services carried out other than the main audit. The number of non-audit services were as outlined below:

1) Taxation
2) Consultancy
3) System Design
4) Secretarial work
5) Financial Advice
6) Receiverships and Liquidations

The following tables further give an in-depth analysis into which various non-audit services were carried out;

**Table 4.16 Taxation**

<table>
<thead>
<tr>
<th>Feedback</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offered</td>
<td>9</td>
<td>100</td>
</tr>
</tbody>
</table>

From the table above, it can be concluded that all the firms (100%) carry out Taxation other than their mainstream audit.

It can therefore be concluded that the most prevalent service offered other than the audit is Taxation. This can be explained further by the fact that all organizations have to file their tax returns with the Income Tax Department, which explains why it is the most popular service offered.

**Table 4.17 Consultation**

<table>
<thead>
<tr>
<th>Feedback</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offered</td>
<td>8</td>
<td>88.9</td>
</tr>
<tr>
<td>Not Offered</td>
<td>1</td>
<td>11.1</td>
</tr>
</tbody>
</table>

The above table further illustrates that most respondent firms (88.9%) offer Consultation services, while only 11.1% do not offer the above service.

It can be concluded that most firms seek these services from auditing firms, especially large going concerns that are seeking to divest or expand their business and need to consult before taking such a bold and major move.

**Table 4.18 System Design**

<table>
<thead>
<tr>
<th>Feedback</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offered</td>
<td>5</td>
<td>55.6</td>
</tr>
<tr>
<td>Not Offered</td>
<td>4</td>
<td>44.4</td>
</tr>
</tbody>
</table>

9
From the above table, we can conclude that 55.6% of the respondents offer System Design compared to 44.4% who do not offer the service.

**Table 4.19 Secretarial Work**

<table>
<thead>
<tr>
<th>Feedback</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offered</td>
<td>8</td>
<td>88.9</td>
</tr>
<tr>
<td>Not Offered</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the results it is clear that a high proportion of the respondents (88.9%) offer Secretarial work as compared to only 11.1% who do not.

**Table 4.20 Financial Advice**

<table>
<thead>
<tr>
<th>Feedback</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offered</td>
<td>8</td>
<td>88.9</td>
</tr>
<tr>
<td>Not Offered</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the study it can be observed that 88.9% of the respondents offered Financial Advice to their clients, compared with a mere 11.1% who do not offer the service.

**Table 4.21 Receivership & Liquidation**

<table>
<thead>
<tr>
<th>Feedback</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offered</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>Not Offered</td>
<td>8</td>
<td>88.9</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Majority of the respondents (88.9%) do not offer the above service to their clients, with only 11.1% offering the service. We can therefore conclude that many clients do not seek this service for one reason or another, with the only firm offering being a multinational company.

The following can be summarized in the pictorial table and graph below;
4.3.8 Peer Audits Conducted on Major Clients

The results from the table below sought to find out whether peer audits were carried out on the respondents' major clients. The table below illustrates this further;

**Table 4.22 Peer audits conducted on major clients**

<table>
<thead>
<tr>
<th>Action</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conducted</td>
<td>5</td>
<td>55.6</td>
</tr>
<tr>
<td>Not Conducted</td>
<td>4</td>
<td>44.4</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>
The results above indicate that 55.6% of the respondents have peer audits carried out on their major clients, while 44.4% do not.

From the above table and chart it can be deduced that most firms have peer audits conducted on their major clients by the colleagues in other auditing firms to ensure that the audit performed has been carried out according to laid down procedural rules, utmost care and due diligence.

4.3.9 How often Auditors are Rotated
The respondents were asked to state how often their auditors were rotated; either semi-annually, annually, after two years or when need arose.

Table 4.23 How often auditors are rotated

<table>
<thead>
<tr>
<th>Regularity</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Semi-Annually</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>Annually</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>After two years</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td>When need arises</td>
<td>4</td>
<td>44.4</td>
</tr>
<tr>
<td>Total</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Most respondents (44.4%) had their auditors rotated only when need arose, while 33.3% rotated their auditors every two years, while only 11.1% rotated their auditors semi-annually and annually respectively.

4.4 Over-Reliance on One Client for Fees

The study sought to find out whether the respondents had major clients whose fees it solely relied on.

The table and pie chart below gives an in depth analysis.

**Table 4.24 Over-reliance on one customer for fees**

<table>
<thead>
<tr>
<th>Response</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td>No</td>
<td>6</td>
<td>66.7</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

**Figure 4.14 Over-reliance on one customer for fees**

Thirty three percent (33%) of the respondents in the study had major clients whose fees it solely relied on, while 66.7% who were the majority did not encourage over-reliance on one client for majority of their fees.
It can therefore be concluded that similar financial pressure can be imposed as a result of over-reliance on one customer and therefore lead to compromise. This is not so important with the bigger firms that were under study, but was a common occurrence with smaller firms. For the big firms under study, the loss of one, even large client may not be very significant.

4.4.1 Auditors and Professional Ethics
The respondents in the study were asked to state whether they endorse professional ethics while performing their jobs.
A hundred percent of the respondents answered to the affirmative. They all concurred that it is of utmost importance to be professional while doing their job. The above is done through the staff signing the professional ethics and independence code.

Table 4.25 Auditors and Professional Ethics

<table>
<thead>
<tr>
<th>Response</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Always</td>
<td>9</td>
<td>100.0</td>
</tr>
<tr>
<td>Sometimes</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td>Never</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.4.2 Criterion used in Selecting Staff
The study sought to find out the criterion used by the respondents in selecting their staff.
High on the agenda of most of the respondents was selection of staff with academic and professional qualifications plus experience on the job. Other respondents on top of selecting individuals with academic, professional qualifications and experience were of the view that it was also very important to seek confidential reports from previous employers and referees so as to determine the integrity of those selected.
The table below gives a clear picture of the findings:

**Table 4.26 Criterion used in selecting staff**

<table>
<thead>
<tr>
<th>Criterion</th>
<th>No.</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Academic and Professional I.T (Information Technology) skills</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>Academic and Professional Qualifications</td>
<td>1</td>
<td>11.1</td>
</tr>
<tr>
<td>Academic and Professional Qualifications &amp; experience</td>
<td>2</td>
<td>22.2</td>
</tr>
<tr>
<td>Academic &amp; Professional Qualifications and Experience plus letter from previous employer</td>
<td>2</td>
<td>22.2</td>
</tr>
<tr>
<td>Professional Qualifications and experience</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>99.9</td>
</tr>
</tbody>
</table>

From the above results, all respondents stressed on possession of academic and professional qualifications so as to be employed in the auditing firms, with 33.3% stated that on top of having academic and professional experience, a candidate should have experience in the particular field, while 22.2% stressed that other than having academic and professional qualifications one should have a letter from their previous employer so as to determine their integrity.

It can therefore be concluded that on overall, most firms insist on academic and professional qualifications as an entry point into the auditing profession with experience and a letter from a previous employer or referee as secondary.

**4.4.3 Disciplinary Measures for Cases of Professional Misconduct**

The respondents in the study were asked to state which existing disciplinary measures were present for cases of professional misconduct among staff. Sixty-six percent (66%) of the respondents opted for dismissal for any reported cases of professional misconduct, while only 33.3% gave out warning letters to their staff first, while only opting for dismissal after already issuing out a warning letter.

The following table and pie chart provides more insight into the above.

**Table 4.27 Disciplinary measures for cases of professional misconduct;**

<table>
<thead>
<tr>
<th>Disciplinary Measures</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dismissal</td>
<td>6</td>
<td>66.7</td>
</tr>
<tr>
<td>Warning Letter</td>
<td>3</td>
<td>33.3</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Out of the respondents interviewed 66.7% of them used dismissal as a disciplinary measure for cases of professional misconduct among their staff while 33.3% used warning letters to reprimand their staff who had not been un-professional while performing their duties.

It can therefore be concluded that in the auditing profession, honesty and integrity are considered as invaluable traits, and must be possessed by auditors if they are to conduct their work professionally.

Figure 4.15 Disciplinary measures for cases of professional misconduct

![Disciplinary Measures Pie Chart]

4.4.4 Factors Strengthening the Auditors Independence

The respondents opinion was sought on the factors strengthening the auditors’ independence. The factors were outlined below with the respondents ranking them in order of importance from Number one to fifteen, with one being the least and fifteen being the most.

Factors strengthening the auditors’ independence

A- Regular rotation of auditors
B- Employing only professionally qualified accountants (CPA K)
C- Prohibition of any direct financial interest or material indirect financial interest
D- Prohibit fee arrangements in which the fee is contingent on findings
E- Avoid heavy involvement in other work such as management, taxation services, system design, secretarial work, financial advice etc

F- Taking reasonable care and skill before, that whatever he is certifying is true

G- Disclosing any known omission or misstatement of significant information in the statements

H- Segregation of duties

I- Putting in place disciplinary measures to discourage auditors’ from compromising their independence

J- The auditor avoiding situations in which he might be tempted to compromise his independence and avoid exposure to such temptation

K- Prohibit engagement in any business or occupation conjointly with public accounting that would be incompatible with public accounting

L- Putting in place disciplinary measures to discourage auditors from compromising their independence

M- Neither the practice, nor partners, audit staff, spouses, or minor children or partners should make or receive loans to or from a client company

N- Guide against undue hospitality i.e. material gifts should not be accepted from clients

O- In cases where conflict of interest may arise, there should be full and frank disclosure to those involved

Table 4.28 Factors strengthening the auditors’ independence

<table>
<thead>
<tr>
<th>Code</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
<th>G</th>
<th>H</th>
<th>I</th>
<th>J</th>
<th>K</th>
<th>L</th>
<th>M</th>
<th>N</th>
<th>O</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>10</td>
<td>12</td>
<td>15</td>
<td>15</td>
<td>10</td>
<td>12</td>
<td>15</td>
<td>15</td>
<td>13</td>
<td>14</td>
<td>15</td>
<td>14</td>
<td>10</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>2</td>
<td>11</td>
<td>6</td>
<td>12</td>
<td>8</td>
<td>13</td>
<td>4</td>
<td>2</td>
<td>5</td>
<td>15</td>
<td>14</td>
<td>10</td>
<td>-</td>
<td>9</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>3</td>
<td>6</td>
<td>1</td>
<td>15</td>
<td>8</td>
<td>9</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>7</td>
<td>12</td>
<td>4</td>
<td>11</td>
<td>13</td>
<td>14</td>
<td>10</td>
</tr>
<tr>
<td>4</td>
<td>14</td>
<td>7</td>
<td>15</td>
<td>4</td>
<td>11</td>
<td>13</td>
<td>6</td>
<td>10</td>
<td>12</td>
<td>5</td>
<td>3</td>
<td>9</td>
<td>8</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>5</td>
<td>15</td>
<td>14</td>
<td>10</td>
<td>11</td>
<td>13</td>
<td>2</td>
<td>5</td>
<td>12</td>
<td>1</td>
<td>6</td>
<td>3</td>
<td>4</td>
<td>9</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>6</td>
<td>1</td>
<td>15</td>
<td>4</td>
<td>7</td>
<td>2</td>
<td>13</td>
<td>12</td>
<td>11</td>
<td>14</td>
<td>10</td>
<td>9</td>
<td>8</td>
<td>6</td>
<td>3</td>
<td>15</td>
</tr>
<tr>
<td>7</td>
<td>2</td>
<td>10</td>
<td>7</td>
<td>4</td>
<td>14</td>
<td>5</td>
<td>13</td>
<td>15</td>
<td>3</td>
<td>6</td>
<td>8</td>
<td>1</td>
<td>9</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td>8</td>
<td>2</td>
<td>6</td>
<td>7</td>
<td>3</td>
<td>1</td>
<td>13</td>
<td>14</td>
<td>12</td>
<td>11</td>
<td>10</td>
<td>5</td>
<td>9</td>
<td>8</td>
<td>4</td>
<td>15</td>
</tr>
<tr>
<td>9</td>
<td>13</td>
<td>1</td>
<td>6</td>
<td>5</td>
<td>9</td>
<td>7</td>
<td>12</td>
<td>10</td>
<td>11</td>
<td>14</td>
<td>2</td>
<td>3</td>
<td>15</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Avg</td>
<td>8.2</td>
<td>6.9</td>
<td>10.1</td>
<td>7.2</td>
<td>9.1</td>
<td>7.9</td>
<td>9.1</td>
<td>10.6</td>
<td>9.7</td>
<td>10.1</td>
<td>6.6</td>
<td>6.6</td>
<td>9.7</td>
<td>7.7</td>
<td>9.0</td>
</tr>
</tbody>
</table>
Most of the respondents considered segregation of duties as the most important factor in strengthening the auditors’ independence which has the highest average score of 10.6 points, followed by prohibiting fee arrangements in which the fees are contingent on findings and for the auditor to avoid situations in which he might be tempted to compromise his independence, which ranked as the second most important factors towards strengthening independence and had a score of 10.1 points. The third most highly rated factors believed to strengthen auditors’ independence were the setting up disciplinary measures to discourage auditors from compromising their independence and prohibiting partners, audit staff, spouses or minor children or partners from receiving loans to or from a client company, which had a score of 9.7 points. Avoidance of heavy involvement in other work such as management, taxation services, system design, secretarial work and financial advices and segregation of duties ranked as the fourth most important factors with a score of 9.1 points.

The fifth most important factor that strengthens auditors’ independence was full and frank disclosure to those involved, in cases where conflict of interest may arise scoring 9 points, and regular rotation of auditors ranking as the sixth most important factor with 8.2 points. Taking reasonable care and skill before certifying anything, guiding undue hospitality, and prohibition of fee arrangements in which the fee is contingent on findings were the seventh, eighth and ninth most important factors towards strengthening auditors independence.
The factors rated as least important were being prohibition of engagements in any business or occupation conjointly with public accounting that would be incompatible with public accounting, putting in place disciplinary measures to discourage auditors from compromising their independence and employing only CPA (K)s', in that order.
CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This chapter provides a detailed data presentation, analysis and discussion. The following format was used to present, analyze and discuss the raw data collected.

5.2 Summary
The purpose of this study was to determine factors limiting the auditors' independence in the auditing profession. The study was important to the external auditors in understanding the users perception of the services they deliver.

5.3 Discussion of Findings

5.3.1 Appointment and removal of external auditors
Respondents were asked to state whose responsibility it was in appointing and removing of auditors in their organizations. Out of the respondents studied, 67% had their auditors being appointed or removed by their shareholders, while in 33.3% of the respondents; it was the directors who were responsible for appointing and removing auditors.

5.3.2 Adequacy of the Rules and Regulations in strengthening the auditor’s independence
When respondents were asked if they felt the rules and regulations were adequate enough to strengthen the auditor’s independence, 44.4% felt the rules present were adequate, while 55.6% were not satisfied, and were of the view that the rules related to non-audit services, should be revised because they felt it impaired the auditors independence. They also wanted requirements put in place requiring certain partners on the engagement team to rotate after no more than 5 or 7 consecutive years, depending on the partner’s involvement in the audit, and exemption given to small accounting firms.
5.3.3 Confidence in the auditors’ ability to do his/her work professionally
Respondents were asked whether they had confidence in the auditor’s ability to conduct his/her work professionally. Results showed that 66.7% of the respondents had confidence in the auditors’ ability to do his/her work professionally, while 33.3% had completely no confidence. They argued that this was because of the level of high audit fees charged together with the director’s strong influence.
They also felt that corruption was very rampant and tended to compromise the auditors’ independence.

5.3.4 Situations where auditors compromise their independence
A section of the users of accounting information were asked to state whether there were situations where they felt the auditor compromised his independence.
Fifty-five (55%) had not experienced situations where the auditor compromised his independence, while 44.4% had encountered such situations.

Those who had experienced situations in which auditors compromised their independence were of the view that large firms, which pay huge audit fees, tend to pressurize their auditors to accept their views as regards particular accounting treatment and disclosures.

5.3.5 Reliance on audited financial statements to make investment decisions
The study sought to find out he level of reliance on audited financial statements while making investment decisions.
Eighty nine percent (89%) of the respondents did not rely on audited financial statements to make big investment decisions, while only a mere 11.1% totally relied on audited financial statements to make decisions.
Majority of the respondents used share prices, the companies’ track record and the opinion of financial consultants before making huge investment decisions. They were not too comfortable on totally relying on audited financial statements alone.
5.3.6 Checks on audit assignments

The respondents were asked to state how they countercheck whether their staff has properly conducted audit assignments.

Most of the respondents agreed unanimously that there was an elaborate audit review carried out by the respective managers in charge of the audit at various levels, and further culminating with the partner in charge of the audit carrying out his own separate review. Thereafter, an independent review was carried out on the whole audit team by their peer audit firms.

5.3.7 Non-Audit Services Offered and whether the firm provides more than one of the above services to one client

The respondents were asked to highlight the number of non-audit services carried out. The most common services offered alongside the audit were taxation, secretarial work, offering financial advice and consultation. System Design, receiverships and liquidations were not very common.

Heavy involvement in other work such as management, consultancy, taxation services, system design etc may mean the fees for other services may be substantially higher than the audit fee itself. This is dangerous, as the auditors may become, or may appear to become too involved in the making or formulating of management decisions from them to remain objective.

5.3.8 Peer Audits carried out on major clients

In majority (55.6%) of the firms peer audits were conducted on major clients, while only 44.4% did not carry out peer audits.

This was carried out so as to ensure that the audit engagement was carried out professionally and according to the laid down procedural guidelines so as to avoid negligence or too minimize any opportunities that may create temptation and therefore compromise the auditor.
5.3.9 How often auditors are rotated
The study sought to find out how often auditors were rotated. Forty-four percent of the respondents only rotated auditors when need arose, with 33.3% rotating auditors every two years. A very small percentage (11.1%) rotated auditors semi-annually and annually respectively, which tended to be a phenomenon the small local firms tended had due to their flexibility.

5.4.10 Over-Reliance on one client for fees
Most firms under study (66.7%) did not rely on one customer for majority of their fees while 33.3% over-relied on particular customers for majority of their fees, which had a negative impact as it imposed financial pressure which led to compromise. This was not very rampant with the big firms under study, but was a common occurrence with the smaller firms. For the big firms, the loss of one, even very large client may not be very significant.

5.4.11 Auditors and Professional Ethics
All the respondents under study were of the view that it was very important to endorse professional ethics while doing their job, which is done through the staff signing the professional ethics and independence code, when entering into employment with any auditing firm.

5.4.12 Criterion used in selecting staff
Out of all the respondents interviewed, all were of the view that academic and a professional qualification together with experience was important in determining who will be accepted to undertake an audit engagement. Other respondents, on top of selecting staff with academic, professional qualifications and experience, felt that confidential reports from previous employers was important in determining the integrity of those chosen, which is important as this is one of the attributes an auditor must possess.

5.4.13 Disciplinary Measures for cases of professional misconduct
The study sought to find out what disciplinary measures were used to reprimand those who had practiced professional misconduct. Majority (66%) of the respondents opted for dismissal as a counter-measure while only 33.3% first gave out a warning letter with dismissal being the last option after all measures failed.
Dismissal they felt was necessary as once an auditor is compromised, he may in future also encounter the same temptation and be compromised once again.

5.4.14 Factors strengthening the auditors' independence

The respondents in the study were asked to rank in order of importance the factors they felt strengthened auditors' independence.

High on the list was segregation of duties and prohibition of fee arrangements in which the fees are contingent on findings. This was considered the most important factor, as financial pressure could be imposed if one client represented a significant proportion of the audit firms’ total fees, more so with smaller firms struggling for survival.

This is perhaps not so important with bigger firms, as the loss of one, even large, audit may not be significant- ‘you win some, you lose some.’

The other highly rated factors were avoidance of heavy involvement in other work such as management, taxation services, system design, secretarial work, financial advice and disclosing any unknown omission or misstatement of significant information in the statements.

The factors rated as least as least important, were employing only professionally qualified accountants, prohibiting engagements in any business or occupation conjointly with public accounting that would be incompatible with public accounting, together with putting in place disciplinary measures to discourage auditors from compromising their independence.

This was because, it was felt disciplinary measures were more like a secondary measures as the ill would have already been done, not to mention the fact that an individual may get away with it when not discovered.
5.4 CONCLUSIONS

The auditing firms in Nairobi constituted the geographical scope of the study. The target respondents were the auditing firms in Nairobi as well as the users of accounting information ranging from investors, government agencies, and suppliers to management.

The study touches on the factors that limit the auditor's independence, and establishes how effectively the rules and regulations can be applied to enhance independence.

On the issue of appointment and removal of auditors, the study established that one third or 33% of the respondents auditors are appointed by the Board of Directors. This is likely to compromise their independence.

Adequacy of the rules and regulations was another factor as 56% of the respondents were not satisfied with the rules.

The research also stresses how important it is for the auditor to avoid situations in which he might be tempted to compromise his independence.

The motivation to do this study arises since no recent study has determined the impact of factors on auditor independence. Since views and attitudes change over time, this study no only updates the views of respondents but uses factors shown to be significant from prior research, that are still important today.
5.5 RECOMMENDATIONS

The following recommendations are necessary based on the findings of the study:

i) Recurring fees from one source should not exceed 15 percent of the gross fee of the practice.

ii) In cases where conflict of interest may arise, there could be full and frank disclosure to those involved, coupled with an action necessary to discharge from one both positions, the conflicting interest of which have occasioned the difficulty.

iii) It is right that members should provide for audit clients other services beyond performing the audit; nevertheless, care must be taken not to perform executive functions or to make executive decisions. These are the duties of management.

iv) All the respondents under study were of the view that it was very important to endorse professional ethics while doing their job, which is done through the staff signing the professional ethics and independence code, when entering into employment with any auditing firm.

v) Keeping track of user perceptions, periodically, could enable the profession to reduce the expectations gap that exists between the profession to reduce the expectations gap that exists between the profession and the users’ of the information. It would also enable the professional to take steps to allay the fears of respondents, which in turn might reduce the risk of litigation against them and increase the perceived quality of the services provided.

vi) More importantly, after the Crisis of Enron, Waste Management and World Com, congress and SEC are more determined to reform the accounting industry and assure auditor independence. After many years of exploration, SEC accepts the Sarbanes-Oxley Act of 2002 in which 8 kinds of non-audit services are banned. The revised auditor independence rules require companies to disclose the amount of all audit and non-audit fees paid to auditors after February 5, 2001.
REFERENCES


APPENDICES

APPENDIX 1- Implementation Schedule & Research Budget

APPENDIX 2 – Cover Letters I, II

APPENDIX 3 – Questionnaire
APPENDIX ONE

RESEARCH BUDGET

<table>
<thead>
<tr>
<th>Activity</th>
<th>COST (Kshs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PROPOSAL WRITING</strong></td>
<td></td>
</tr>
<tr>
<td>Typing</td>
<td>3,000</td>
</tr>
<tr>
<td>Diskettes and Stationery</td>
<td>1,800</td>
</tr>
<tr>
<td><strong>DATA COLLECTION</strong></td>
<td></td>
</tr>
<tr>
<td>Travelling expenses</td>
<td>5,000</td>
</tr>
<tr>
<td>Research Assistants</td>
<td>10,000</td>
</tr>
<tr>
<td>Facilitation</td>
<td>6,000</td>
</tr>
<tr>
<td><strong>DATA ANALYSIS</strong></td>
<td></td>
</tr>
<tr>
<td>Thesis Writing</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>35,800</strong></td>
</tr>
</tbody>
</table>

IMPLEMENTATION SCHEDULE

<table>
<thead>
<tr>
<th>Activity</th>
<th>Duration (months)</th>
<th>Time Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposal Writing</td>
<td>Two</td>
<td>July - October</td>
</tr>
<tr>
<td>Field Work</td>
<td>Two</td>
<td>November - January</td>
</tr>
<tr>
<td>Data Analysis</td>
<td>Four</td>
<td>February - March</td>
</tr>
<tr>
<td>Thesis Writing</td>
<td>Four</td>
<td>April - July</td>
</tr>
</tbody>
</table>
APPENDIX TWO

LETTER OF INTRODUCTION

May 2003

Dear Respondent,

MIBA RESEARCH PROJECT

This Questionnaire is designed to gather information on the factors limiting the external auditor’s independence in the auditing profession. The study is being carried out for a Finance project paper as recruitment in partial fulfillment of the degree of Master in International Business Administration, United States International University-Africa.

__________

STELLA B. MOGERE
MIBA STUDENT
FACTORS LIMITING AUDITOR INDEPENDENCE IN THE AUDITING PROFESSION

QUESTIONNAIRE FOR THE MANAGING PARTNER/AUDIT SENIOR

Dear Respondent,

This Research seeks to investigate the extent to which the external auditor's independence is compromised with a view to establishing how effectively the rules and regulations can be applied to enhance the external auditors independence.

This study has been motivated by the fact that, to appreciate that lack of independence of auditors is a problem in Kenya and the world at large. Given the significance of this topic, we consider you to be an important part of the study. In this regard, we will be grateful if you would kindly spare some time to provide information relating to the questions that follow.

Thank you in advance.
APPENDIX THREE

QUESTIONNAIRE FOR MANAGING PARTNER/AUDIT SENIOR

1) How long has your audit firm been in business? Tick if appropriate.
   A) 1-5 years
   B) 5-10 years
   C) 10 years and above
   D) Other

2) How many auditors are employed in your firm? -------------------

3) How many of these auditors are professionally qualified (CPA K) -------

4) How many audit trainees are employed in your firm? ------------

5) How does your firm countercheck if staff employed by yourselves has properly
   conducted audit assignments?

6) What other non-audit services does your company offer? Tick if appropriate.
   A) Taxation
   B) Consultancy
   C) System Design
   D) Secretarial Work
   E) Financial Advice

7) Does your firm provide more than one of the above services to one client? -------

8) Do you have peer audits being conducted on your major clients? --------

9) How often are your auditors rotated? Tick if appropriate.
   A) Semi-annually
   B) Annually
   C) After two years
   D) Other

10) Does the company have major clients whose fees it solely relies on? -------
11) Do auditors in the company endorse professional ethics while doing their job?

   A) Always
   B) Sometimes
   C) Never

12) What criterion does your firm use in selecting its staff or peer audit firms?

13) What disciplinary measures do you put in place for any cases of professional misconduct carried out by your staff? Tick whichever is appropriate.

   A) Dismissal
   B) Warning Letter
   C) Legal Redress
   D) Salary Deductions
   E) Any Other

14) Rank in order of importance factors you think will strengthen the auditor’s independence. 1-15 (1 lowest, 15 highest)

   A) Regular rotation of auditors--------
   B) Employing only professionally qualified accountants (CPA K) ---------
   C) Prohibition of any direct financial interest or material indirect financial interest----
   D) Prohibit fee arrangements in which the fee is contingent on findings--------
   E) Avoid heavy involvement in other work such as management, taxation services, system design, secretarial work, financial advices etc --------
   F) Taking reasonable care and skill before, that whatever he is certifying is true ------
   G) Disclosing any known omission or misstatement of significant information in the statements ----------
   H) Segregation of duties------
   I) Putting in place an appropriate code of ethics to strengthen auditors independence ---------
   J) The auditor avoiding situations in which he might be tempted to compromise his independence and avoid exposure to such temptation ---------
   K) Prohibit engagement in any business or occupation conjointly with public accounting that would be incompatible with public accounting--------------
   L) Putting in place disciplinary measures to discourage auditors from compromising their independence ---------

64
M) Neither the practice, nor partners, audit staff, spouses, or minor children or partners should make or receive loans to or from a client company--------

N) Guide against undue hospitality i.e. material gifts should not be accepted from clients ---------

O) In cases where conflict of interest may arise, there should be full and frank disclosure to those involved --------

P) Any other comment ---------

---------------------------------------------------------------

---------------------------------------------------------------
QUESTIONNAIRE

The questionnaire has been developed with the aim of identifying users' perception of services delivered by the auditor and also identifies the need for improvement in their service delivery. All information will be treated with utmost confidentiality. Your assistance will be highly appreciated.

1. What is the average tenure of service of directors employed in your organization?
   □ 1 year   □ 1-5 years   □ 5-10 years

2. Who are the company's auditors (Tick where appropriate)
   □ Deloitte and touche   □ Price Waterhouse Coopers   □ KPMG
   Others (Please specify) __________________________________________

3. How long have they been the company's auditors?
   □ 1 year   □ 1-5 years   □ 5-10 years

4. Who is responsible for their appointment or removal of external auditors?
   A) Directors
   B) Employees
   C) Shareholders
   D) Any Other ________________________________

5. How many employees are in the Accounts department?
   □ 10   □ 10-20   □ 20-30
   □ Above 30 (Specify) __________________________

6. How often do you recruit fresh graduates into your Accounts department?
   □ Yearly   □ Once every 5 years

   □ Others (Specify) __________________________
7. What are the minimum qualifications an individual has to have to be considered as an employee within the accounts department?

8. Do you believe the rules and regulations present are adequate enough to strengthen the auditors independence?

☐ Yes  ☐ No

If not, what suggestions may you offer towards this end or what extra mechanism do you think needs to be put in place inorder to ensure adherence.
Rank in order of importance 1-7 (1 lowest, 7 highest)

A) Revise the rules related to the non-audit services that, if provided to an audit client would impair an accounting firm’s independence;
B) Require that certain partners on the audit engagement team rotate after no more than 5 or 7 consecutive years, depending on the partner’s involvement in the audit, except that certain small accounting firms may be exempt from this requirement;
C) Establish rules that an accounting firm would not be independent if certain members of management of that issuer had been members of the accounting firm’s audit engagement team within the one-year period preceding the commencement of audit procedures;
D) Establish rules that an accountant would not be independent from an audit client if any “audit partner” received compensation based on the partner procuring engagements with that client for services other than audit, review and attest services;
E) Require that the auditor report certain matters to the issuer’s audit committee, including “critical” accounting policies used by the issuer;
F) Require the issuer’s audit committee to pre-approve all audit and non-audit services provided to the issuer by the auditor; and
G) Require disclosures to investors of information related to audit and non-audit services provided by, and fees paid to, the auditor.

9. Do you have full confidence in auditors and their ability to do their work professionally?

☐ Yes  ☐ No

If No, why?  

67
10. Are there situations you have come across whereby auditors compromise their independence due to one reason or another?

☐ Yes      ☐ No

If Yes, Give reasons

11. Do you totally rely on audited financial statements to make investment or financial decisions?

☐ Yes      ☐ No

If no, what other sources do you rely on?

A) Share prices
B) Track Record
C) Seek opinion of financial consultants
D) Company’s financial performance
E) Any Other———
