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Do Audit Firm Size and Their Services Matter on Auditor Independence: A Case of Indonesia

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Abstract

This paper examines whether audit firm size and services provided by audit firms affect auditor independence. The ultimate purpose of this research is to gain an in depth understanding on the issue of auditor independence from auditors' perspectives in respect to different audit firm size and different services they provided to their clients.This research uses qualitative approach. Interviews with auditors have been conducted in order to gain data. Auditors are from big four audit firm, as well as from medium and small audit firm located in Indonesia(non big-four audit firm). Data analysis uses summarizing, pattern coding (miles and Hubberman, 1984) description and interpretation as suggested by Walcott (1994).

The research resuls indicated that on the audit firm size issue, seventeen of twenty-nine auditors did not agree with the proposition stating that the bigger the audit firm, the more independent their auditors. Their arguments were that auditor independence depends on the auditor's integrity, personality and strength of character. Conversely, another twelve auditors supported the proposition with the following two arguments. First, the bigger the audit firms, the less they depend on individual clients. Second, the bigger the audit firms, the more 'instruments' they have for maintaining independence such as appropriate divisions, more experts, more advanced technology and international links.

On the issue of providing non-audit services to audit clients this study did not find conclusive responses from the auditors. This study found that a majority of auditors (twenty of twenty-nine) did not agree with the proposition stating that the provision of non-audit services by audit firms to audit clients could impair auditor independence. Their arguments were: first, the big five audit firms have different divisions for different services, and the non-big five audit firms send different staff for different services; and second, they offer non-audit services which have no impact on the clients' decision making process. This finding is consistent with studies conducted by Gul and Teoh (1984) and Buchman (1996). On the other hand, four auditors believed that providing non-audit services by audit firms to audit clients could impair auditor independence. Their reason was simply that this issue could generate a conflict of interest for auditors. These four auditors supported the studies conducted by Shockley (1981), Moore (1983), Lindsay (1999) and Wines (1994).

Keywords*: Audit Firm Size, Audit Services, Auditor Independence, Indonesia.*

Introduction

The main objective of audit is to ensure whether the financial statements are prepared based on proper accounting standards. Because of this purpose therefore, auditors must be independent in fact and independent in appearance. Otherwise, the audited report will be bias and even misslead the financial statements' users.

This study is inspired by the situation that audit fims have different size which have different number of auditors as well as the services provided by audit firms to their clients which one audit firm is different from the other. Some audit firms have grown into large international audit firms, frequently called as the big-four audit firms. These audit firms are linked world-wide. On the other hand, local audit firms, ranging from one to several partners still exist. Because of the different natures of local/small and large audit firms, the size of audit firms is perceived to be a factor that could affect auditor independence (Shockley, 1981, p. 786). The larger the audit firm, the smaller the contributions of certain clients' fees, therefore the larger audit firms are less dependent on individual clients (Mautz and Sharaf, 1961, p. 213). This perception has led to several empirical researches. On the size of audit firm issue, previous examined studies have shown a conclusion that the larger the audit firm, the more independent their auditors (Shockley, 1981; Amernic & Aranya, 1981; Supriyono, 1988; Lindsay, 1989; Kleinman et al, 1998).

On the issue of audit and non-audit services provided to clients, many researchers include the non-audit service issue in their studies, it can be stated that the non-audit services issue is the most researched issue on auditor independence. Providing non-audit services by audit firms to audit clients will increase the question of auditor objectivity and independence (Agacer and Doupnik, 1991). It is clear that, once an audit firm renders non-audit services to its particular client, its independence will be attacked by its conflict of interest, between maintaining its independence and professionalism and following a client's pressure to gain financial interest. In general, previous studies on the effect of non-audit services to audit clients on auditor independence have had inconsistent findings (Kleinman et al 1998). Some studies have confirmed that providing non-audit services will impair the perception of auditor independence (see Shockley, 1981; Moore, 1983; Lindsay, 1999; Wines, 1994;). On the other hand, the findings of other studies argued that providing non-audit services to audit clients does not affect the perception of independence (see Gul and Teoh, 1984; Pringle and Buchman, 1996).

Based on the discussion above therefore this reserach is intended to investigate the effect of audit firm size and services provided to client with the following research question: Do Audit Firm Size and Their Services Matter on Auditor Independence?

2. Literature Review

2.1 Audit Firm Size

Audit firm size is considered to be one of the issues that could affect auditor independence. This is because the larger audit firms are considered to be more independent for at least two reasons. First, because of the firms' size, the audit fee generated from a particular client constitutes a smaller percentage of the audit firm's total revenue. Second, larger audit firms normally have many divisions to provide the services needed by clients, and therefore the person who audits the client would be different from the person who provided non audit services. On the contrary, the situation at a small audit firm differs as an auditor handles more varied duties and also the audit fee generated from a particular client constitutes a larger percentage of audit firm total revenue. From this situation, there is a proposition that auditors from a larger audit firm would act more independently than auditors from a smaller audit firm. Therefore, this study aims to investigate auditors' perceptions as to whether audit firm size could affect auditor independence or not.

Some audit firms have grown into large international audit firms, frequently called the big-five audit firms. These audit firms are linked world-wide. On the other hand, local audit firms, ranging from one to several partners still exist. Because of the different natures of local/small and large audit firms, the size of audit firms is perceived to be a factor that could affect auditor independence (Shockley, 1981, p. 786). The larger the audit firm, the smaller the contributions of certain clients' fees, therefore the larger audit firms are less dependent on individual clients (Mautz and Sharaf, 1961, p. 213). This perception has led to several empirical researches. On the size of audit firm issue, previous examined studies have shown a conclusion that the larger the audit firm, the more independent their auditors (Shockley, 1981; Amernic & Aranya, 1981; Supriyono, 1988; Lindsay, 1989; Kleinman et al, 1998).

2.2. Non-Audit Services

Basically, there are two types of services offered by auditors, attestation service and non-attestation service. According to Gill and Cosserat (1993, p. 10) attestation service is rendered by auditors to their clients where the auditors issue a written communication, which expresses a conclusion about the reliability of a written assertion that is another party's responsibility. This includes services such as audit, examination, review and other agreed upon procedures. When auditors perform a non-attestation service they do not issue an opinion, negative assurance, summary of finding or other form of assurance (p. 11). Services such as accounting, tax, management consulting, and insolvency and business recovery are examples of non-attestation services commonly rendered to clients.

As part of the attestation service rendered by auditors, audits can be divided into three major types; financial statement audits, compliance audits and operational audits (Pany & Whittington 1997, p 12; Porter, Simon & Hatherly, 1996, p. 3). Financial statement audit refers to an examination of a company or institution's financial statements conducted by an independent auditor. The main aim of this audit is to confirm whether accounting standards have been properly applied in the company's financial statements. A compliance audit is conducted to examine whether the auditee has done (or is doing) its activities in accordance with the procedures or regulations established by an authority. This audit is prepared for the authority that has set up the regulations.

An operational audit, according to Pany & Whittington (1997, p. 12) is a study of a specific unit of an organization for the purpose of measuring its performance. While Gul, Teoh and Andrew (1992, p. 5) defined operational audit as an appraisal activity within an organization for the review of entire departmental operations as a service to management. To make it simple, in this study services offered by audit firms will be divided into audit and non-audit services.

Since many researchers include the non-audit service issue in their studies, it can be stated that the non-audit services issue is the most researched issue on auditor independence. Providing non-audit services by audit firms to audit clients will increase the question of auditor objectivity and independence (Agacer and Doupnik, 1991). It is clear that, once an audit firm renders non-audit services to its particular client, its independence will be attacked by its conflict of interest, between maintaining its independence and professionalism and following a client's pressure to gain financial interest. In general, previous studies on the effect of non-audit services to audit clients on auditor independence have had inconsistent findings (Kleinman et al 1998).

Some studies have confirmed that providing non-audit services will impair the perception of auditor independence (see Shockley, 1981; Moore, 1983; Lindsay, 1999; Wines, 1994;). On the other hand, the findings of other studies argued that providing non-audit services to audit clients does not affect the perception of independence (see Gul and Teoh, 1984; Pringle and Buchman, 1996). From this situation, there is a proposition that audit firms which do not provide Non-Audit Service would act more independently than audit firms which provide Non-Audit Services to their audit clients.

3. Methodology

This research uses qualitative approach. Data collection is based on interviews with twenty-nine auditors. In terms of structure, Krathwohl (1998, p. 288) states that interviews can be categorised as structured or relatively unstructured. The sort of interview used in this study was selected, based on the purpose of the research. Sarantakos (1993, p. 178) states that structured interviews are based on a rigorous procedure and heavily structured questions. The use of this type of interview is associated with survey research (May, 1997, p. 100). May (1997, p. 110) furthermore, asserts that structured interviews allow the researcher to compare between responses. While unstructured interviews, conversely have no strict procedures to follow like the wording of questions, the order of questions, or the interview schedule (Sarantakos, 1993, p. 178), by using unstructured interviews, the researcher has an aim in mind but the interviewee can be free to talk about topic (May, 1997, p. 113).

For the purpose of this study, the researcher expected to be able to compare the responses through the use of a confirmation survey, one of the data collection methods proposed by Le Compte & Goetz (1984, p. 45), to verify the issues raised with the auditors and to make a comparison between the auditors' responses. Therefore a semi-structured interview that lies between a structured and an unstructured interview, seems to be the best choice for this study.
In this research, interviewees come from:

- Big four and non big-four audit firms
- Partners and non-partners

All the interviewees from the non big-four audit firms are partners. On the other hand, the interviewees from the big-four audit firms are partners, managers, assistant managers and supervisors. The reason for selecting partners in the non big-four audit firms, was because the number of employees in this type of audit firm is normally less than fifty. Therefore the hierarchy of audit firms is not very 'complicated'. Meanwhile, the hierarchy of the big-four audit firms is more complicated.

Brewer (2000, p.188) defines data analysis as "the process of bringing order to the data, organizing what is there into patterns, categories and descriptive units, and looking for relationships between them".

There is no consensus among researchers as to the forms of analysing qualitative data (Creswell, 1998, p. 140). Marshall and Rossman (1999, p. 152) for example, identify analytic procedures into six phases. These are: (i) organizing the data; (ii) generating categories, themes and patterns; (iii) coding the data; (iv) testing the emergent understandings; (v) searching for alternative explanations; and (vi) writing the report.

On the other hand, Miles and Huberman (1984, p. 21) state that data analysis involves three sub-processes: data reduction; data display; and conclusion drawing/verification. Data reduction 'refers to the process of selecting, focusing simplifying, abstracting, and transforming the 'raw' data' (p. 21). They assert that data reduction is part of analysis. Data display refers to 'an organized assembly of information that permits conclusion drawing and action taking' (p. 21). This involves assembling data into displays like matrices, charts, graphs, and networks. This process is considered to be analytic activities. Conclusion Drawing is 'beginning to decide what things mean, noting regularities, patterns, explanations, possible configurations, causal flows and propositions' (p. 22).

This study however, follows the combination of the analytic procedures developed by Wolcott (1994b) and Miles and Huberman (1984) in analysing qualitative data for two reasons. First, by borrowing the transforming qualitative data of Wolcott, the researcher will be able not only to analyse what the auditors said, but also be able to analyse the meaning of what they have said. Second, by using data reduction, display and conclusion drawing on Miles and Huberman (1984), the researcher will be able to organise and present data in a comparable format between responses. Data in this study was collected by interviews with twenty-nine auditors in the Indonesian language. Therefore, organizing and presenting data in this study includes the following steps: (i) transcription; (ii) translation; and (iii) data reduction and pattern coding.

4. Research Findings

4.1. The Effects of Audit Firm Size

To investigate the effects of audit firm size on auditor independence, twenty-nine auditors were interviewed, sixteen were from the big-four audit firms (Deloitte, Ernst and Young, KPMG, and Pricewaterhouse Coopers) and thirteen from non-big five audit firms. The sixteen auditors from the big four included partners, directors, senior managers, managers, assistant managers and supervisors. The thirteen auditors from small and medium audit firms were all partners.

This configuration of interviewees is expected to give a proper representation in terms of audit firm size, because they all come from different sized audit firms. All the interviewees were asked about their perceptions as to whether auditor independence was affected by audit firm size (their audit firms) or not, using the following question, "Do you think auditor independence is affected by audit firm size?" To aid understanding of the issue being discussed, before asking that question they were told that there was a proposition that the bigger the audit firm the more independent would be their auditors, and in the smaller the audit firm the auditors would be less independent.

From the twenty-nine auditors interviewed, there were two main answers. Seventeen auditors did not agree with the proposition, and twelve auditors agreed with the proposition with some 'notes'.

4.1.1. Auditor Independence: A Personal Matter

Of the seventeen auditors who did not agree with the proposition that audit firm size affected independence, nine of them worked for a big-five audit firm and seven auditors worked for a non big-four audit firm. They did not agree with the statement for the following three reasons. The first reason was that because independence is a personal matter, auditor independence was not caused by the size of the audit firms where the auditors work but rather it depended on the auditor's integrity and personality. As stated by Mr. E, a big four audit partner.

> I don't agree with that statement, because that statement is too generalized about people's character. I believe that independence is an individual matter, so where they work will not necessarily affect their independence. I can be independent in this audit firm, not because of this firm but because of my integrity and personality as an auditor. However, it doesn't mean that the above statement is completely wrong. Public opinion, I think is constructed by the existence of audit firms themselves. I mean the bigger the audit firms,

> the better their management, the better their job description and distribution. The smaller the audit firms, the more centralised decisions will be made by staff, which will lead to conflict of interests. Therefore, in my opinion that statement is a general statement that we need to be careful of in order to avoid misleading statements. (Mr. E)

The second reason they argue is that there are some auditors from the big four who compromise auditor independence. It is not necessarily that the big five auditors are always independent. It is because the big four auditors sometimes also 'compromise' their independence, as stated by Mr. B, a non big-four audit partner.

> I don't agree with that statement, I know that some auditosr from big audit firms some times have their independence impaired. In my opinion the thing that can make a difference between a big audit firm and a small audit firm is only prestige. (Mr. B)

Another reason why auditors object to the statement is because it is viewed as a general statement, and they prefer to view the situation on a case by case basis. However, this group of auditors does not totally disagree with the proposition saying that the bigger the audit firm, the more independent their staff. They view big audit firms as being better in terms of management, job description and distribution and, this view can be seen in the statement of Mr. E.

4.1.2. Large Audit Firms: Building Confidence, Less Dependence

On the other hand, there were another twelve auditors who agreed with the opinion, that the larger the audit firms, the more independent their auditors. These twelve auditors mentioned the following reasons for their agreement with the statement.

According to this group of auditors, the first reason why audit firm size could affect auditor independence is because they perceive that the bigger the audit firms the more clients they have. Therefore, big firm auditors will depend less on individual clients compared to small firm auditors who have a lesser number of clients. This situation would improve the confidence of big firm auditors from the threat of losing clients, so consequently big firm auditors would be 'more' independent compared to small firms auditors. The following statement of Mr. A, a partner of a non-big four audit firm clarifies this situation.

> I believe that auditors who work in a bigger audit firm will be more independent than auditors who work in a smaller audit firm. Because the bigger the audit firm, the more clients they have, so they will not depend on some clients. However, it does not mean that auditors from the bigger audit firm will always be more independent than auditors from smaller audit firms. (Mr. A)

From Mr. A's statements, it is obvious that Mr. A still believes that small firm auditors can still be independent.

A second reason why this group agrees with the view that the bigger the audit firm, the more independent their auditors is because this group of auditors believes that the bigger the audit firm, the more instruments they have to maintain auditor independence, for example they have many divisions to provide different services (consequently they have more appropriate experts), they possess more advanced technology and are internationally linked. The following reason stated by Mr. O, a big-four audit partner reveals this clearly.

> I agree with that statement but I don't totally agree. I said that I agree because in a big audit firm, auditors have many instruments to support their independence, for example: they have different divisions, they have more advanced technology, they have more advance audit system, they have more confidence and so on. While in smaller audit firms, they have less facilities compared to the bigger audit firms. However, I don't totally agree with the above statement because even though auditors work in smaller audit firms, they can be independent without worrying about the above factors I mentioned as long as they try to be a real independent auditor is their profession. (Mr. O)

Another reason why they agreed with the view that the bigger the audit firm the more independent their auditors was because small firm auditors tend to look for clients, while big audit firms do not. This was stated by Mr. F, a non big-four audit firm as follows:

> In small audit firms we are required to look for clients not like in big firms. So, auditors' independence in small audit firms could be more impaired than auditors in large firms. The above statement could be right. But we have to see that case by case and not generalize. (Mr. F)

Those twelve auditors mostly agree with the proposition. However, they do not totally agree with the proposition saying that the bigger the audit firm the more independent their auditors. Those auditors included some provisos such as everything relates to auditors' integrity (Mr. A), it needs to be viewed on a case by case basis (Mr. F), and small auditors also can be independent (Mr. A).

From the twenty-nine auditors who were interviewed, there were seventeen auditors who disagreed with the proposition saying that the bigger the audit firms, the more independent their auditors. Another twelve auditors agreed with the proposition. Both groups were not absolute in their opinions but presented a number of provisos. The reasons put forward by those who disagreed with the proposition included the belief that auditor independence is a personal matter, not affected by the firm where they work. They also believed that some big firm auditors compromised auditor independence, and they viewed the proposition as being too general. They needed to view each case individually.

From the reasons provided by those who disagree, it appears that they viewed independence as an individual matter. Any auditor can be independent as long as they have a strong integrity and personality regardless of where they work. This view is consistent with the first circumstance affecting independence introduced by Flint (1988) saying that independence depends on the auditor's quality, which includes integrity, objectivity and strength of character. This is also consistent with the warning proposed by Goldman and Barlev (1974) that auditors of large firms are not immune from client pressure.

However, this group of auditors do not totally disagree with the proposition, they still 'understand' that the bigger the audit firms the more specialization and better management they have and the smaller the audit firms the more centralization of decisions and the potential for conflict of interest. It would seem that even though they disagreed with the proposition, they could not refuse the realities as stated by Mr. E, that big audit firms have better instruments for being independent. Because of that this group of auditors did not agree that auditor independence was determined merely by audit firm size (where they work). They preferred, therefore, to see auditor independence as an individual case, not as a generalization.

The reasons given by those who agree with the proposition saying that the bigger the audit firm the more independent their auditors, is because they said that the bigger audit firms had more clients. This is understandable, since the big audit firms (the big-four) normally have hundreds to thousands of clients, from small to big clients, compared to small audit firms who may have only about ten (or sometimes less than ten) to fifty clients. This reason interestingly is acknowledged not only by the big-four audit partners, but also by the non-big four audit partners.

This group of auditors also held the opinion that the bigger audit firms had more instruments for being independent. Instruments like divisions for providing different services that are not possessed by small audit firms and this, they thought, would minimize conflicts of interest. More experts possessed by big audit firms would improve the auditors' confidence, whereas small audit firms have only a limited number of staff. Control from the headquarter office of big four audit firms, also contributes to the confidence of big four auditors.

The last reason was that small audit firms tend to look for clients, while the big audit firms do not. Since the number of clients of small audit firms is limited, it is not surprising that they tend to 'seek' clients or try to retain their clients more than the big four audit firms. This second group of auditors supported the studies of Shockley (1981), Amernic and Aranya (1981), Supriyono (1988) and Lindsay (1989), which found that the smaller audit firm tend to be less independent.

However, all these auditors do not totally agree with the proposition. They still think that there is a big possibility for those who work at small audit firms to be independent, as stated by Mr. A and Mr. O. Therefore, the generalization for auditors in this regard, is not appropriate, it would be better to see the effect of audit firm size on auditor independence on a case by case basis as stated by Mr. F. The reasons given by auditors who agreed with the proposition are based on audit firm sizes. While the reasons proposed by auditors who disagreed with the proposition are based on the auditors' integrity and personality. It is important to note that audit firm characteristics (such as separating services by divisions, advanced technology, more expert, better management, control from headquarter) would support auditor independence. On the other hand, the strength of auditor integrity and personality would be very significant for auditors.

4.2. Non-Audit Services

The rendering of non-audit services such as taxation, information system design, human resource management and management consultancy to audit clients will increase the question of auditor objectivity and independence (Agacer and Doupnik 1991; Firth 1997). Once an audit firm renders non-audit services to its particular client, its auditors' independence will be attacked by their conflict of interest, between maintaining its independence and professionalism and following the client's pressure to gain financial interests. This is at least caused by two reasons, first, the audit firm does not want to criticize the work done by its non-audit service division and second, the audit firm doesn't want to lose profitable non-audit services, therefore the audit firm will not be keen to disagree with management's interpretation of accounting matters (Firth 1997). From this situation, there is a proposition that rendering non-audit services to audit clients could impair auditor independence. This study therefore intends to investigate auditors' perceptions as to whether providing non-audit services to audit clients could affect auditor independence or not.

4.2.1. The Effects of Providing Non-Audit Services

To investigate the effects of providing non-audit services (to audit clients) on auditor independence, the twenty-nine auditors were asked for their opinion with the question "Can you tell me the effects of providing non-audit services to audit clients on your independence?" Before being asked the question, they were told that there were views and empirical studies stating that providing non-audit services to audit clients by auditors (audit firms) can impair auditor independence, and the question was being asked to confirm whether it was 'true' or not according to the auditors' perceptions.

Of the twenty-nine auditors, five of them said that they never offered non-audit services to their audit clients. Therefore, only twenty-four auditors offered non-audit services to audit clients. Twenty auditors said that providing non-audit services to audit clients has no effect on auditor independence. While another four auditors said that providing non-audit services to audit clients has an effect on auditor independence. Of those four auditors, three of them clearly said that providing non-audit services impaired auditor independence, and one said that it impaired independence to some degree.

4.2.1.1. Various Divisions, Selective and Limiting Non-Audit Services

This section will explore the reasons provided by the twenty auditors who said that providing non-audit services to audit clients has no effect (did not impair) on auditor independence. In the interviews each auditor's answer provided one or two reasons. For those who said that providing non-audit services has no effect on impairing independence, their answers, however, can be categorized into five general reasons.

First, fifteen auditors (ten from the big-five audit firms and five from non big five firms) said they believed that providing non-audit services to their clients would not impair auditor independence because the big four audit firms had different divisions for different services. And those from the non big-five audit firms said that even though they had no 'formal' divisions they sent different staff to provide different services. The reasons given by the ten auditors from the big for are similar to the following statements of Mr. O, a partner of a big four firm and reasons given by the five auditors from the non big four are similar to the answer of Mrs. M, a senior partner of a non big-five audit firm.

> Well in our audit firm, we have different divisions like the audit division, financial advisory services and so on. Based on the divisions we have, we can be more professional because there wouldn't be a responsibility overlap. By separating our services the responsibility overlap will be minimized, so through this way independence in appearance will not be impaired because the public know that we have separate work divisions and responsibilities. This maintains our independence in fact automatically, because by separating the divisions it can minimize conflicts of interest. So, in my opinion providing both services to the same client would not result in impairing independence. (Mr. O)

> We rarely provide both services to the same clients, but if this happen we can still be independent, because we assign our different assistants when we do audit and non-audit services. By sending our different assistants, we feel secure about our independence. I don't have any responsibility to defend my client's interest even if they are my non-audit clients (Mrs. M)

Second, three auditors (all from the big-four, two partners and one manager) said that providing non-audit services will not impair auditor independence because they were selective in offering non-audit services, not all services were offered to clients, and only less risky non-audit services were offered to clients. The following statement by Mr. L, a senior partner of a big four firm, argued that selecting the NAS offered to audit clients is a way to 'maintain' independence.

> Well, this matter has guidance in audit standards. If you are an auditor you are not allowed to be a clients' financial advisor, because those works have a conflict of interest. But if you provide non-audit services like tax, management consulting, accounting compilation, it's no problem at all. Auditors will have a conflict of interest when they act as a decision-maker for their clients or they have significant roles for their clients. But so far, in my case I have no problems with my independence as an auditor as long as we are strict to avoid something that could lead us into a conflict of interest. (Mr. L)

The third reason why providing non-audit services has no effect on auditor independence is because non-audit services offered to clients have no significant role in the clients' decision making process. This reason was proposed by two auditors, both of them were partners of non-big four audit firms. The following statement delivered by Mr. B, a partner of a non big-four audit firm highlights this reason:

> We provide both services, but not many companies are clients of both. However, even though some of them are both audit and non-audit clients our independence is not affected, because we provide a small part of the non-audit services, which is not significant to the clients' decision making process. (Mr. B)

The fourth reason why providing non-audit services does not impair auditor independence is because of the strength of the auditor's integrity and personality, and the fifth reason is because the auditor follows audit rules and standards. The fourth and fifth reasons were only stated by one auditor each.

4.2.1.2. Non-Audit Services: Generating Conflict of Interest

On the other hand, four auditors (three were members of big four firms, and one of a non big-four firm) said that providing non-audit services to audit clients would impair auditor independence. Their reasons were because they saw a conflict of interest while performing audit tasks to their non-audit services clients. The following paragraphs express the views of those auditors.

Mr. J, an assistant manager of a big four firm and Mr. Y, a partner of a non big- four firm said that providing non-audit services to the same clients will impair auditor independence during the performance of audit tasks, but they said that this impairment is still tolerable because it is not significant.

Mrs. T a senior manager from a big four firm says that providing non-audit services could impair auditor independence if both services were done by the same staff, but it would depend on the auditor's integrity if audit service and non-audit services were conducted by different staff and a different division.

Mr. X, a partner of a big four firm said that providing non-audit services to audit clients probably would impair the appearance of independence because the public would look at the services provided by the one audit firm, even though it had different divisions. However, independence in fact according to Mr. X, will depend on the auditor's integrity. The following statement by Mrs. T is similar to Mr. X's, and suggests that it is obvious that the auditor's integrity is very important in maintaining auditor independence.

> In my opinion, providing both audit and non-audit services, if conducted by the same persons, could impair auditor independence both in fact and in appearance. If those services are conducted by different persons from different divisions, this case is dependent on the auditors' integrity. If they have strong integrity they wouldn't be affected, but if they have weak integrity, they would be affected. So, it depends on how good audit firms manage their staff and divisions, and how strong the integrity of their auditors is.

4.2.1.3. Not Offering Non-Audit Services: A Safe Choice

Five auditors, all partners of non-big four audit firms prefer not to offer Non-Audit Services to their audit clients at the same time, even though there is no prohibition in offering and accepting those services. Their reason is to avoid a conflict of interest. The following statement by Mrs. P makes more obvious their fear of getting involved in a conflict of interest.

> I have no clients that accept both of our services. If they are audit clients, I don't offer them non-audit services. If I offer them non-audit services, I don't want to be their auditor. Also I don't offer tax services in my business, because in my opinion taxation is more negotiable. So I have no experience in providing both services to the same clients. Consequently, my independence has nothing to do with that issue. (Mrs. P)

The majority of the auditors (twenty) interviewed agreed that providing non-audit services to audit client does not impair auditor independence. This view is consistent with studies of Gul and Teoh (1984) and Knapp (1985). Only four auditors think that providing non-audit services to audit clients could impair auditor independence. This study shows that only four auditors support the studies of Shockley (1981), Moore (1983), Supriyono (1988), Lindsay

(1989), and Teoh and Lim (1996). While five auditors preferred not to offer non-audit services, in addition to audit services, to their clients.

The question on non-audit services raises three issues: auditing and non-audit services divisions; auditor's integrity; and conflict of interest. The existence of a non-audit services division in audit firms has been proposed as the main reason for maintaining independence for those who said that providing non-audit services has no effect on auditor independence. For those who said that providing non-audit services could impair auditor independence, they thought that the existence of a non-audit services division could only minimize the impairment of independence.

It is important to note, that all big-four audit firms have divisions for providing different services. While the non-big four audit firms generally do not have different divisions for providing these services, this study suggests that all audit firms should have appropriate divisions to conduct different services, otherwise it would be better not to offer non-audit services to audit clients, as has been instituted by five auditors.

The existence of different divisions for providing different services is important, but would be of little use if an auditor's integrity is weak. The strength of an auditor's integrity is one reason proposed by an auditor who thinks that providing non-audit services to audit clients has no effect on auditor independence. Integrity can be possessed by anyone, whether they are a member of a big-four firm or a non-big four firm.

Conflict of interest can cause auditors trouble. Their independence is threatened when they have a conflict of interest. The best way to maintain auditor independence is by avoiding conflict of interest. It is important that all services offered to clients do not result in a conflict of interest for auditors. Also, the role of non-audit services offered to clients needs to be reviewed to see how significant they are in affecting client's decision making process. Again, the decision taken by those who do not offer non-audit services to their audit clients is a very good example of avoiding conflict of interest.

5. Conclusion

This paper has discussed the findings of the study relating to the effect of audit firms, namely audit firm size and non-audit services offered by audit firms to audit clients. On the audit firm size issue, seventeen of twenty-nine auditors did not agree with the proposition that the bigger the audit firm, the more independent their auditors. Their arguments were that auditor independence depends on the auditor's integrity, personality and strength of character. Therefore, some of these auditors suggest viewing auditor independence not from the size of the audit firm but more specifically in relation to auditor qualities.

Conversely, another twelve auditors supported the proposition with the following two arguments. First, the bigger the audit firms, the less they depend on individual clients. Second, the bigger the audit firms, the more 'instruments' they have for maintaining independence such as appropriate divisions, more experts, more advanced technology and international links. These two reasons were consistent with the view of Mautz and Sharaf (1961, p. 213) and the study by Shockley (1981).

Even though this study did not find consensus on this issue, both groups acknowledge that all auditors can be independent wherever they work, as long as they have proper auditor qualities as argued by Flint (1988). However, for illustration purpose, if there are two auditors with the same 'quality', where one works for a big four firm and the other one works for a small audit firm, the first auditor can be argued as being potentially more independent than the second. This is because the characteristics of the big audit firm are more encouraging than a small audit firm in maintaining independence. But once again, auditors from a small audit firm can be independent as long as they maintain integrity.

The interviews showed that the larger audit firms were believed to have a positive effect on auditor independence. This study, therefore, concludes that the larger audit firms 'potentially have a positive effect' on auditor independence.

On the issue of providing non-audit services to audit clients this study did not find conclusive responses from the auditors. This study found that a majority of auditors (twenty of twenty-nine) did not agree with the proposition saying that the provision of non-audit services by audit firms to audit clients could impair auditor independence. Their arguments were: first, the big four audit firms have different divisions for different services, and the non-big four audit firms send different staff for different services; and second, they offer non-audit services which have no impact on the clients' decision making process. This finding is consistent with studies conducted by Gul and Teoh (1984) and Buchman (1996).

On the other hand, four auditors believed that providing non-audit services by audit firms to audit clients could impair auditor independence. Their reason was simply that this issue could generate a conflict of interest for auditors. These four auditors supported the studies conducted by Shockley (1981), Moore (1983), Lindsay (1999) and Wines (1994).

Meanwhile, the study found that five auditors, all of them from non-big four audit firms do not offer non-audit services to their audit clients at all. This was interesting, since there was no prohibition on the offer of non-audit services to audit clients. Their decision not to offer non-audit services to their audit clients was to avoid conflict of interest. These auditors were aware that providing non-audit services was potential income, but they were worried that the provision of this service would lead to the impairment of their independence.

Although no prohibition on offering non-audit services to audit clients exists, this study suggests that those who have no non-audit services divisions should not offer non-audit services to their audit clients unless they have different staff and a different partner in charge of audit and non-audit services to minimise a conflict of interest.

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