

AUDITOR INDEPENDENCE

Putting things in perspective



By
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Auditor independence has once again come under scrutiny. A recent commentary suggested that “trust in external assurance is being eroded”, and the picture painted of the auditing profession is far from rosy. Mandatory audit firm rotation yet again surfaced as a viable safeguard to ensure auditor independence. But is it, really?

I aim to shed some light on the current state of play for the auditing profession, in the hope of putting the issue of auditor independence in perspective.

Independence is a state of mind which makes it hard to prove. It is not visible to the public. So even if the auditors are truly independent, if the market does not perceive them to be so, the value of their work and output will still come to nothing.

Behaving ethically and thinking objectively is not good enough if they do not lead to a positive view being formed by the market on their independence. The biggest challenge for the auditors is therefore in demonstrating their independence. The auditors are

in quite a predicament. They are expected to measure up to the market’s definition of independence, that is, they have “to be seen” to be independent. This often requires auditors to demonstrate compliance with some visible safeguards imposed on them. Mandatory audit firm rotation, mandatory re-tendering and limiting the provision of non-audit services are some visible safeguards which have been imposed by certain jurisdictions. Certain stakeholders

continue to call for such safeguards to be imposed on auditors just to be doubly sure that auditors are really independent.

Such calls are hardly surprising because to believe that an auditor would go against the wishes of the very organisation that pays his fees is counter-intuitive. Auditing is probably the only profession caught in this paradox.

Therein lies the argument for more visible safeguards. That being said, auditors would tell you that they have reputational risk and legal risk to contend with and would

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therefore take it upon themselves to implement effective safeguards. We should therefore look at the auditing profession as a whole and not a few black sheep when analysing the independence issue.

No doubt, auditor independence is key to maintaining trust in the financial information. But it is not something that we should lose sleep over, especially in Singapore. Singapore boasts a robust regulatory framework, strong corporate governance structure, and the adoption of codes and standards which are aligned with international standards.

All Singapore public accountants and accounting entities are required to comply with the code of professional conduct and ethics, and standards on quality controls, with independence being upheld through compliance with



such codes and standards. Although you cannot read an auditor's mind, he can demonstrate compliance with codes and rules through his actions and documentary proof.

To me, the most effective mechanism in ensuring auditor independence is really the mandatory compliance with the code of professional conduct and ethics and the standards on quality control with effective oversight by the regulator.

The current Code of Professional Conduct and Ethics already spells out, among others, the types of non-audit services auditors shall avoid and the requirements to have sufficient safeguards in place when accepting non-audit services. The standards on quality control also require proper procedures to be put in place to ensure that a new client can be accepted or

existing ones retained if, and only if, the firm can demonstrate independence from the client, among other criteria. Regulators would then check that the auditor is indeed independent through documentary proof supporting his compliance with those code and standards.

Investors in Singapore are fortunate. Not only are our ethical code and quality control standards aligned with international code and standards which are developed through robust

due process, we also have a regulator that acts without fear or favour in their audit oversight work. Our regulators do not succumb to pressure and continue to uphold the highest standard of quality in their inspection work. Their views are highly valued and their advice sought by audit regulators of our neighbouring countries in setting up the system and structure of the latter's audit oversight body.

Singapore has a transparent and strong governance structure, especially for listed companies which have a stronger element of public interest. With effect from September 2011, all listed companies in Singapore are required to disclose the aggregate of the fees paid to auditors, broken down into audit and non-audit fees. Additionally, audit committees are

required to confirm that they have reviewed the non-audit services provided by the auditors and these services would not impair the auditors' independence. The listing rule also requires rotation of audit partner in charge of the audit of a listed company at least once every five years.

Regulators keep the auditors on their toes through enforcement of such rules. Hence, I choose to think that although the paradox continues to exist, the ethical code, standards on quality control and regulatory oversight are sufficient to uphold the independence of auditors.

Can more be done? Absolutely. The work of audit committees is largely not visible to the investing public. I support the call for audit committees to make publicly available the reports about their assessment of auditor independence, their oversight of the auditor and the audit process. Their basis of retaining or changing auditors should also be made transparent. The public can then make their own evaluation of whether or not the auditor's work can be relied upon.

Whilst I agree that more can be done to strengthen auditor independence, further research is required to substantiate the effectiveness of each proposed safeguard before its imposition.

Some attention every now and then to remind the auditing profession of the importance of upholding independence is welcome but imposing unnecessarily burdensome safeguards is not. The latter may have the adverse effect of curtailing the growth of the profession.

We still need the profession to lend trust to the financial information for the market to function effectively. It is about looking at the big picture. ISCA

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