

DOES PROVISION OF NON-AUDIT SERVICES IMPAIR AUDITOR INDEPENDENCE? WITH SPECIAL REFERENCE TO SMALL AND MEDIUM SCALE AUDIT FIRMS

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Demand for auditing primarily stems from the intention of mitigating conflict of interest among different stakeholders associated with a business entity. The external auditors act as a guarantor of the reliability of the financial statements prepared by the management. Otherwise the stakeholders who do not have adequate access to internal affairs and information of the business may hesitate to make their investment decisions based on the information disclosed by the management. Therefore, an opinion expressed by an independent external auditor adds credibility to the financial statements. However, recent accounting scandals like Enron have casted a doubt over the independence of auditors and the overall value of auditing. In Sri Lanka as well, there have been few cases where the auditors' role and independence was challenged. Auditor's independence may be impaired due to several causes. Amongst them, the provision of non-audit services to the client by the incumbent auditor has become one of the major causes behind the diluted auditor independence. Therefore, this study investigated whether the provision of non-audit services impairs the auditor's independence based on the data during 2008-2012 on 10 small and medium scale audit firms located in the western and southern provinces in Sri Lanka. Interviewing and a questionnaire-based survey were used as main data collection methods where the qualitative methods were used for analysis. Results revealed that the provision of non-audit services results in self-interest, self-review, familiarity and intimidation threats which eventually deteriorate the auditor independence of small and medium scale audit firms. Therefore, the separation of non audit services from the incumbent auditor would result in higher integrity of the financial statements.

Keywords: Auditor independence, Credibility of financial reporting, Non audit service