

## DOES THE PROVISION OF NON-AUDIT SERVICES AFFECT AUDITOR INDEPENDENCE AND AUDIT QUALITY? EVIDENCE FROM BAHRAIN

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### ABSTRACT

*The main aim of this research is to investigate perceptions of respondents (auditors, accountants and financial managers) on the effect of provision of non-audit services (NAS) to audit clients companies upon auditor independence and audit quality. This study expands on previous work done on the effects of providing non-audit services upon auditors' independence and audit quality in Bahrain, which considered as an important subject for both auditing firms and auditing profession. This paper provides insights on the factors which explain the impact of the provision of non-audit services upon auditor independence and audit quality in Bahrain. To achieve the objectives of the research, a questionnaire was prepared and disseminated to a sample of 250 respondents. The results indicate that respondents are supporting the idea that "independence of auditor is impaired with providing non-audit service". Kruskal-Wallis Test revealed that only respondents' occupation is associated with their perceptions. Providing empirical evidence on this issue within the Bahraini environment, as a member of the Gulf Cooperation Council countries, may add a new dimension to the accounting and auditing literature. As the study analysed only one country (Bahrain); generalisation of the results might be a limitation. Future research studies should consider other countries in the region and to include respondents in other non-listed companies with more recent data which may lead to different results.*

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## **INTRODUCTION**

The last two decades have witnessed a wide expansion in services rendered by auditing firms to include various non-audit services (NAS) and this was due to the expansion and complication of business environment, the globalisation, the spreading of multinational companies and the improvements of information technology. Companies nowadays receive NAS such as computer hardware and software installation, human resources planning, bookkeeping, tax return preparation, investment banking, internal audit out-sourcing, and finally management advisory services (Jenkins & Krawczyk, 2001).

The globalisation in accounting and other services such as assurance service has formed 'the multidisciplinary nature of big audit firms' (Brierley & Gwilliam, 2003), which would present audit and NAS to audit clients and this became one of the major issues concerning the possible auditor independence dilemma (Craswell, 1999; Quick & Warming-Rasmussen, 2005). Jenkins and Krawczyk (2001) pointed out that histrionic changes in the accounting profession, brought about factors such as globalisation and information technology, have formed the need to rethink independence standards, and therefore explore the influence of NAS on auditor independence. The global financial crisis experienced in the last decade has formed a lot of doubts regarding the usefulness of auditor's report and therefore, NAS fees has been a challenge for further investigation.

The US regulators adopted nine types of NAS that inconsistent with auditor independence. Examples of these services include bookkeeping, the design and implementation of financial information systems and valuation services or fairness opinions, internal auditing services, planning of human resources, actuarial services, and legal services (Sarbanes & Oxley, 2002). Beattie, Fearnley and Brandt (1999) provided evidence from the UK and concluded that most of NAS provided by auditors is accounting services that enable client companies to conform to the legal and regulatory requirements rather than management consultancy. Dykxhoorn and Sinning (1981) concluded that the majority of German auditors believed that auditor independence would be abused when auditors offer widespread accounting consultancy or services.

Lindsay, Rennie, Murphy and Silvester (1987) investigated the influence of providing a number of services (namely, preparation of accounts, executive search and accounting systems design) on auditor independence in the Canadian

environment. They concluded that accounting systems design was seen as the smallest threat on auditor independence. However, they found that about a third of the respondents considered the other two services, preparation of accounts and executive search, makes auditor dependent on client. This expansion is expected to improve the firm's competitiveness, to maintain continuous growth, and to satisfy customers.

However, the extension of services has upraised inquiries about whether auditing firms can sustain their independence while offering NAS to audit clients. Without independence, audit cannot achieve its goals, which is the basic requirement for an auditor to be able to perform an audit. The auditor in public practices must be free of bias with respect to client and must be recognised as independent by users of the audit report.

Performing audit and NAS for the same client might cause a lack on independence for the auditor, because this may create a working relationship that is too close between the auditor and the client. Consistent with this view, Jordan Companies Law (1997) stated in its rule No. 235: An auditor is not allowed to participate in the foundation of the corporation that is being audited by him, nor to be a member of administrative or advisory position, also he is not allowed to be a partner or an employee for any member of that corporations' board of directors.

This study is expected to provide additional empirical evidence on auditors' independence and audit quality in Bahrain, which considered as an important subject for both auditing firms and the audit profession. Independence is viewed as a strong shield that may protect auditors from any threats or pressures from the board of directors of the audit clients' side. This study is likely to contribute to the accounting and auditing literature in the following grounds: (1) to fill the gap in the existing auditing literature because there is little published studies directly investigating NAS models in developing countries in general and Bahrain in particular; (2) to the best knowledge of the researchers, there was only one study conducted in Bahrain by Joshi, Bremser, Hemalatha and Al-Mudhaki (2007) to directly investigate the effect of providing NAS upon auditor independence in Bahrain and by now about 10 years passed and became old and needs to be updated. Another feature that distinguish this study from its previous study in Bahrain (Joshi et al., 2007), is that this study takes into consideration the impact of demographic variables upon auditor independence and financial reporting quality whereas, the previous study did not. Furthermore, this study investigated the impact of providing NAS upon quality of financial reporting.

Further and most importantly, this investigation comes after issuing and applying the Corporate Governance Code (CGC) in Bahrain, which has been

issued by CBB and effective since 2011. The Bahraini CGC aims to make the Corporate Governance practices transparent and understandable for both local and foreign investors in a well liberalised and more transparent economic system (Central Bank of Bahrain [CBB], 2011). Bahrain performed much effort to create the right climate to attract more regional and international investments in order to ensure sustainable growth and to create increased employment opportunities. The 2013 Index of Economic Freedom states that Bahrain is placed as the first in the Middle East and North Africa (MENA) area and ranked as 12 in the world rank (The Heritage Foundation, 2013).

## **BACKGROUND OF THE STUDY**

Bahrain was selected for this study since it enjoys a significant location among Gulf countries, with stable political and economic environment and runs a free market economy. The motivation of this study is the rising concern for providing NAS because of very few studies regarding the influence of providing NAS upon auditor independence and audit quality in Bahrain as one of developing countries with an emerging stock market. Thus, this study is expected to fill the gap in the accounting and auditing literature about this important issue.

In emerging stock markets, the role of auditors as a mean of decreasing conflicts of interest in financial reporting decisions is possibly more significant than in the case of developed stock markets (Chadegani, Mohamed, & Jari, 2011). Consequently investigating that providing NAS by auditors to audit client companies may weaken auditor independence and eventually audit quality, become very important in developing countries such as Bahrain. This study examines the unique condition in Bahrain where the company commonly attempts to negotiate the audit fees and there is a trend for the company to select an auditor who provides variety of NAS and the cheapest audit fees. Therefore, the study is directed towards exploring the effect of providing NAS by external auditors on auditor independence and audit quality.

The main contribution of this study lies in the fact that it has been accomplished in a unique environment (i.e., the Middle East and in particular a Gulf country of Bahrain). Bahrain has a little number of large companies with audit services being concentrated in the hands of only a few audit firms. Providing empirical evidence on the impact of providing NAS upon auditor independence and audit quality within such environment may add a new dimension to the accounting and auditing literature. However, most companies in Bahrain do not disclose audit fees in their annual reports. The findings of this study offer an important insight into this issue in developing countries like Bahrain. In addition,

the findings of this study might help regulators of financial reporting and auditing services in Bahrain in particular, other countries with similar environmental characteristics such as some the Gulf Cooperation Council (GCC) countries in particular and other developing countries in general.

A limited number of studies have been accomplished in GCC countries in general and in Bahrain in particular where the local stock market is not greatly advanced. This could be due to insufficiency of infrastructures, some shortage of transparency and a more conservative approach for revealing and analyzing data relating to auditor independence (Joshi et al., 2007). Studies to investigate the influence of providing NAS to audit client upon auditor independence and audit quality are likely to add value, particularly in Bahrain which is considered as a financial center of the Middle East region. Accordingly, this study focuses on investigating the perceptions of auditors, accountants and financial managers working in listed companies in Bahrain Bourse on the issue of providing NAS to audit client companies and its influence upon auditor independence and audit quality. More specifically, the objectives of this study are as follows:

1. To investigate respondents' perceptions upon the influence of providing NAS to audit clients on their independence and audit quality.
2. To investigate respondents' perceptions about the provisions of NAS has no impact on auditor independence and audit quality.
3. To investigate the impact of demographic variables of the respondents on their perceptions.

Although most previous research on the influence of providing NAS to audit client companies upon auditor independence and audit quality have been conducted in developed countries and very few were done in developing countries, this study is to address this imbalance by having a closer look on this issue in Bahrain. The problem statement is focused upon examining the effect of providing NAS to audit clients upon the auditor independence and audit quality. In addition, examine the effect of three demographic variables namely occupation, years of experience and level of education upon respondents' perceptions on auditor independence and audit quality. Bahrain is characterised as a tax-free country and is a member of the International federation of Accountants (IFAC) since 2004 and also applies International Financial Reporting Standards (IFRS).

Audit services in Bahrain are delivered by variety auditing firms. Some firms are local, others are working as foreign branches, and the residual are interrelated with international audit firms. The Big Four, i.e., Ernst and Young (E&Y), Deloitte & Touche (D&T), KPMG, and Price water house Coopers (PWC)

have a strong presence in Bahrain. Companies in Bahrain are legally requested to have their financial reports audited at reasonable fee without compromising on audit quality. Furthermore, auditors expect to perceive adequate fees for their services to maintain satisfactory level (Khasharmeh, 2015).

Practically, audit firms may need to have two licenses, first for practicing auditing profession and second for providing auditing services to companies of the banking and insurance sector. According to article (205) of the Bahrain CCL No. 21 of 2001, appointment of auditors should be done on an annual basis during the course of the firm's annual general meeting (Said & Khasharmeh, 2014). Concerning auditor's independence, Article (61) of the CBB and Financial Institutions law No. 64 of 2006 presents some conditions for the auditor to be regarded as independent. Before a particular licensee assigns an auditor, it must take accountable steps to make sure that the auditor has the required skills, resources and experience to perform the audit task appropriately, and is independent of the licensee (CBB, 2015).

The results of this study are expected to raise knowledge on how listed companies and audit firms in Bahrain reflect auditors' fees via their reporting practices. As a member of GCC, Bahrain and other members share a number of particular structural economic characteristics. Among these characteristics are: a high reliance on oil as expressed in the share of oil and gas revenues in total fiscal and export revenues; young and rapidly growing national labor forces; and the substantial reliance on expatriate especially in the private sector. Furthermore, listed companies in the GCC members countries are subject to nearly similar financial reporting requirements. Thus, GCC are expected to benefit from the results of this study.

The rest of this paper contains the relevant literature review and hypothesis development, the research methodology, findings and results of the study, and lastly the conclusions.

## **LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

More than 50 years ago, auditor independence has been of great importance. For example, Mautz and Sharaf (1961) stated that auditor independence is a keystone of the auditing profession, a critical element in the statutory financial reporting process and a crucial prerequisite for adding value to audited financial reports. Robert Mednick, Chair of the Board of Directors at American Institute of Certified Public Accountants (AICPA), stated that auditor independence is the cornerstone of the accounting and auditing profession and one of its most

valuable assets (AICPA, 1997). The auditor is expected to be objective, impartial and independent (Osei-Afoakwa, 2013). In addition to be independent in fact, auditors should be seen to be independent in investigating and attesting clients' financial reports (Stevenson, 2002). Specifically, auditors are likely to be able to decide independently on reporting strategies starved of any effect from their client companies' management (Chandler & Edwards, 1996; Cullinan, 2004).

The literature in accounting and auditing provides many previous studies that have been conducted in the area of audit and NAS (Gul & Yap, 1984; Teoh & Lim, 1996; Arrunada, 1999; Beattie et al., 1999; Canning & Gwilliam, 1999; Jenkins & Krawczyk, 2001; Ezzamel, Gwilliam, & Hollan, 2002; Frankel, Johnson, & Nelson, 2002; Chung & Kallapur, 2003; Felix Jr, Gramling, & Maletta, 2005; Quick & Warming-Rasmussen, 2005; Chukwunedu & Okafor, 2014). It has been concluded that the association between providing NAS and auditor independence is a controversial, ambiguous, conflicting issue (Kleinman, Palmon, & Anandarajan, 1998; DeFond, Raghunandan, & Subramanyam, 2002; Frankel et al., 2002; Chung & Kallapur, 2003; Geiger & Rama, 2003; Ashbaugh, 2004; Kinney, Palmrose, & Scholz, 2004; Reynolds, Deis, & Francis, 2004), thus, three views regarding providing NAS were indicated in the literature.

### **Independence of Auditor is Impaired by Providing NAS**

The concern about NAS is established on the supposition that auditors may be willing, at least intensely tempted, to sacrifice their independence in exchange for retaining their audit client companies from which they might accumulate big NAS revenues (DeFond et al., 2002). Because of the provision of NAS, the auditor practice and independence are debatable and third party may think that accounting and auditing practices will be with lower value. However, some authors argued that the auditor provision of NAS creates close working relationship amongst the auditor and the client companies (Wallace, 1995; Sutton 1997).

Chukwunedu and Okafor (2014) concluded that the NAS impair audit independence and audit objectivity. The impairment or absence of auditor independence is a key reason for a lot of corporate collapses and corporate scandals around the world, including the US Case of Enron where the existence of high NAS fees paid to the auditor of Enron was the major instigator to blame for the audit failure. Even though auditors are requested to retain their neutrality and independence, there are some motivations that may induce auditors to compromise their independence. The provision of NAS by auditors to their audit client companies has been seen as a threat to auditor independence (Craswell, 1999). In New Zealand, Gul (1989) investigated respondents' perceptions,

banking staff, and reported that the impact of providing NAS was significantly positively correlated with auditor independence.

The provision of NAS has the possibility to make economic bonding from the substantial amount of fees which received from clients (Simunic, 1984; Beck, Frecka, & Solomon, 1988). This bond might weaken both definite and perceived independence of auditor because of the reluctance of audit firm to criticise the consultancy work provided by one or more of its divisions, and the audit firm may not want to miss lucrative and may, therefore, more unwilling to disagree with management's interpretations of accounting matters (Ping, Carson, & Simmett, 2006). Frankel et al. (2002) reported that auditors may permit further discretion to their clients that pay high payment for NAS compared with total audit fees. Krishnan, Sami and Zhang (2005) provided empirical evidence that investors perceive NAS as weakening auditor independence. Joshi et al. (2007) clearly indicated that auditor independence is impaired when the auditor provides NAS for the audit client.

On the other hand, Abdul Wahab, Zain and Abdul Rahman (2015) conducted a study which contributes to the extant literature through examining the impact of political connections as a threat to auditor independence. They examined the impact of political connections upon auditor independence and investigated the relationship between non-audit fees and audit fees and as to whether political connections moderate such relationship. The results revealed a positive and significant relationship between non-audit fees and audit fees.

Moreover, others researchers (Lowe & Pany, 1995; Frankel et al., 2002; Gendron, Suddaby, & Lam, 2006; Alleyne, Devonish, & Alleyne, 2006; Richard, 2006) claimed that with the provision of NAS, auditors could not be able to deliver the audit services objectively and that the provision of NAS could impair perceived auditor independence because ultimately they could be responsible for auditing their own work and/or acting as management (Security and Exchange Commission [SEC], 2001), and management's power over the auditor may be inflated as a result of auditors' reliance of fees received (Canning & Gwilliam, 1999).

Sori and Karbhari (2006) revealed that auditor independence would considerably threaten when an audit engagement team jointly provide audit and NAS. Similarly, Beattie et al. (1999) reported that a high level of fees from NAS was ranked as the most threat factor on auditor independence by three groups of users namely financial journalists, preparers, and financial directors. Sori, Karbhari and Mohamad (2010) concluded that auditors' independence is perceived to compromise when audit firms jointly offered audit and NAS. Sharma

and Sidhu (2001) surveyed auditors' opinions of bankrupt companies and reported that higher NAS fees have impact on auditor opinion concerning going concern. It is pointed in the literature that the provision of NAS could raise the risk of client retention because of economic incentives, and the tendency to agree with client's choice of accounting policies (Beck et al., 1988; Frankel et al., 2002). Thus, after the collapse of Enron, the Sarbanes Oxley Act 2002 was enacted in the US, with provisions to prevent audit firms from providing specific NAS.

Causholli, Chambers and Payne (2015) examined in their study whether the provision of NAS can impair auditor independence. They argue that it is the potential for new NAS revenue that would most likely cause auditors to have impaired their independence. They found "strong evidence that audit quality suffers when clients are willing to purchase future NAS from their auditors". Patrick, Vitalis and Mdoom (2017) conducted a study to review literature related to auditor independence and audit quality. They found that there is a strong relationship between auditor independence and audit quality. However, Antle, Griffin, Teece and Williamson (1997) stated that the provision of NAS would not affect auditor independence, since it leads to enhance audit quality.

Albaqali and Kukreja (2017) conducted a study to identify the factors influencing auditor independence in Bahrain. The study found a significant role to the audit regulations and related provisions in enhancing audit independence. The study recommended the formation of an independent audit quality board and considering the adoption of a joint audit practice for the listed companies in Bahrain. Based on the above literature review, the following alternative hypothesis was developed:

H1: There are differences in respondents' answers about impairment of auditor independence as a result of providing audit and NAS (questions 1–11 tested this hypothesis).

### **Audit Quality is Improved and Enhanced by Rendering NAS**

According to Wallman (1996), the provision of NAS improves the auditor's capability to learn more about clients, so assisting to make sure that they satisfy their obligation to conduct a better audit. Others showed that provision of NAS certainly improves auditor independence and nevertheless enhances clients' operations (Jenkins & Krawczyk 2001; Kinney et al., 2004; Lowe & Pany, 1995). The auditor client may get better and more complete services especially when consulting in certain areas such as tax services are provided by the auditor.

It was concluded that audit firms providing some of the NAS could bring a great deal of value to audit clients (Antle et al., 1997; TunUda, 2002). Arrunada (1999) stated that the provision of NAS by auditors to their audit clients reduces total costs, increase technical competence and motivates more intense competition and it does not necessarily damage auditor independence or the quality of NAS.

Palmrose and Saul (2001) indicated that the arrangements in which audit firms delivered, both audit and NAS, the NAS has a supportive influence on the effectiveness of the audit. Sawan, Alzeban and Hamuda (2013) found that the provision of NAS improves audit quality. Furthermore, some forensic auditors testified that specific types of frauds might have been eliminated or identified if NAS had been delivered to the audit client or if well communication had ensued between NAS personnel and the audit engagement team (Joshi et al., 2007).

Park, Choi and Cheung (2017) conducted a study to examine how audit quality is affected by an independent auditor providing audit and non-audit service together. The study found that non-audit service significantly affects audit service quality before controlling for endogeneity. Furthermore, Khasharmeh and Nympha (2017) conducted a study to examine the effect of ownership structure upon the audit quality in Bahrain. The results indicated that foreign ownership has a significant relationship with audit quality. Based on the above literature review, the following alternative hypothesis was developed:

H2: There are differences in respondents' answers about improving audit quality as a result of rendering NAS (questions 12–22 tested this hypothesis).

### **The Provision of NAS Has No Impact on Auditor Independence**

It has been reported in the literature that no considerable evidence that investors and their agents are concerned about NAS. For instance, it was reported by Bloomfield and Shackman (2008) that there is a limited evidence to support the concept that companies with more fees of NAS are more expected to restate their earnings, thus casting uncertainty on the public perception that NAS may impair auditor independence.

Sucher and Bychkova (2001) and Quick and Warming-Rasmussen (2005) revealed that NAS has no effect on perceptions of independence. Kinney et al. (2004) and Bugeja (2011) supported this view and found in their study that no statistical associations between fees for the design of accounting information systems and application or internal audit services and restatements. Carmona, Momparler and Lassala (2015) conducted a study to explore whether the provision

of NAS by public accounting firms undermines audit quality. The results of the study found that “high non-audit services do not necessarily result in poor quality financial reporting”. Zhang, Hay and Holm (2016) examined in their study the effect of providing NAS upon auditor independence in the Norwegian audit markets. They found that providing of NAS does not suggest loss of independence.

Another study conducted by Sobrinho and Bortolon (2016) upon 154 Brazilian companies to evaluate whether the provision of NAS affects auditor independence. The results indicate that the provision of NAS does not affect auditor independence. From the above discussion, it can be seen that different perceptions exist about the impact of the provision of NAS on auditor’s independence. Some previous studies concluded that auditing firms that provided NAS had a higher risk for losing their independence, while others concluded that providing NAS had no effect on independence, as well as on financial statement reliability. Based on the above literature review, the following alternative hypotheses were developed:

H3: There are differences in respondents’ answers about the idea that providing NAS has no effect on auditor independence (questions 23–26 tested this hypothesis).

On the other hand, the accounting literature provides evidence that some studies on preparers or users’ perceptions reported significant differences among different groups (e.g. Wallace, 1988 and Solas & Ibrahim, 1992), while others did not (Al-Mubarak, 1997 and Desoky, 2002). Accordingly, this study investigates the perceptions of different groups namely auditors, accountants and financial manager in listed companies in Bahrain Bourse on the effect of the provision of NAS by the auditor on auditor’s independence and audit quality.

The importance of including financial managers group in the study lies in the fact that they have a major concern in audit reports. For financial managers, auditor independence is very essential factor in the audit function; the more the auditor’s independence is sustained, the more the reliability of the financial reports provided by audit firms. Furthermore, demographic information of respondents is used to examine whether the differences in background characteristics of respondents result in differences in their perceptions. Remenyi (1998, p. 154) stated that “background questions provide demographic and socio-economic information on the individual or firm. At the individual level these include evidence on age, gender, occupation, income, education level, ...”. In this study, demographic information was used to examine whether differences in background characteristics of respondents result in differences in their perceptions. There were two main reasons for examining the background characteristics of respondents:

first, to help in grouping the analysis into several sub-groups in order to ascertain whether their answers were significantly different across the various sub-groups; second, to help in assessing the importance of each sub-group within the total sample.

Respondents were categorised by occupation (three groups), years of experience (four groups) and level of education (four groups).

Based on the above, the following alternative hypotheses were developed:

H4: There is association between respondents' occupation and their perceptions on auditor independence and audit quality.

H5: There is association between respondents' experience and their perceptions on auditor independence and audit quality.

H6: There is association between respondents' education and their perceptions on auditor independence and audit quality.

Non-parametric statistics are used for testing the above hypotheses. For example, the Chi-square Test is used to test hypotheses H1, H2 and H3; while Univariate Analysis and Kruskal-Wallis Test are used to test hypotheses about differences between groups (hypotheses H4, H5 and H6).

## **RESEARCH METHODOLOGY**

This study is an explanatory study which aims to verify the hypotheses about the effect of providing NAS to audit client on auditor independence and audit quality. To gather the data necessary for testing hypotheses stated earlier, a questionnaire was designed and tested for the reliability to check the internal consistency, as a method of assessing the reliability of the instrument or the scales used in the study. Cronbach's Alpha is considered the best known and most frequently used test of internal consistency (Sekaran, 2006). According to Pallant (2013), ideally, the Cronbach alpha coefficient of a scale should be above 0.7. Further, Sekaran (2006) stated that in general reliability less than 0.60 is considered to be poor, those in the 0.7 range, are acceptable, and those over 0.8 are good. This means that whenever the coefficient above 0.7, the scale can be considered reliable with the sample. In this research, Cronbach's Alpha coefficient was good with a scale of 0.801 and is considered high.

In general, the main difficulty often met by researchers using the questionnaire as a data collection method is the poor response rates. In this study, every possible effort was made, in the questionnaire design, distribution and collection stages to make the response rate as high as possible. When a study is applied in local areas and/or the researcher is able to assemble groups of respondents to response to the questionnaire, for the case of this study, administering the questionnaire personally is the best way of data collection. (Ibert, Baumard, Donada, & Xuereb, 2001; Sekaran, 2006). The questionnaires were distributed to and collected from a sample of 250 respondents including three interested groups working in the Bahraini firms (namely: auditors, accountants and financial managers) and 199 questionnaires were received, however, the researchers exclude 4 questionnaires because a lot of questions are kept unanswered and leaving 195 useable questionnaires which representing 78% of the questionnaires distributed.

## **SAMPLE SIZE AND SELECTION**

Since this study focuses on investigating the respondents' perceptions at listed companies in Bahrain Bourse on the issue of providing NAS to audit client and its influence upon auditor independence and audit quality. Auditors, accountants and financial managers were selected to be the sample of the study. Auditors are chosen because they are the key subjects of the issue of interest that offer information credibility assessment to the stakeholders (Humphrey, 1997).

Managers are the agent of the owners, who conducts business on behalf of the owners and, hence, necessitates a monitoring mechanism (i.e., an auditor) to give report on their performance (Jensen & Meckling, 1976). On this basis, financial managers' perceptions of auditor independence and audit quality are valued to the study. Accountants are directly involved in providing credible information and their perceptions are valuable to the study. The sample of the study was contacted personally and the questionnaire was distributed either via e-mail or personally by hand. However, some respondents presented apprehension concerning responding, despite the awareness of confidentiality. This is may be due to the nature of the information required and the sensitivity of the topic of this study.

The sample size depends on a number of factors such as available time, funds, access to possible participants, proposed techniques of statistical analysis, the desired degree of precision (de Vaus, 2001). Regarding the estimation of the actual sample size, Saunders, Lewis and Thornhill (2012) proposed a formula that can be used for this purpose. This formula requires two main factors to be estimated: first, the expected response rate, and second, the minimum or the

adjusted minimum sample size. This formula is as follows:  $n^a = (n \times 100) / re\%$ , where  $n^a$  is the definite sample size required,  $n$  is the minimum (or the adjusted minimum) sample size, and  $re\%$  is the expected response rate expressed as a percentage (Saunders et al., 2012). Based on the above formula, total of 180–200 respondents was considered to be enough as a minimum sample size, with subgroups of sufficient size to enable the researchers to compare them (Desoky, 2002), and a response rate of between 65% and 80% was expected. Consequently, the sample size could be calculated as follows:  $n^a = (180 \times 100) / 75 = 240$  respondents. Accordingly, it was decided to distribute 250 questionnaires, to allow for unexpected circumstances. Table 1 explains the response rates of the sample.

Table 1  
*Distributions of the questionnaires and response rates*

Respondents	No. of QD	No. of QR	No. of IQ	No. of UQ	% of UQ
Auditors	120	101	2	99	82.5*
Accountants	65	55	1	54	83.1*
F. Managers	65	43	1	42	64.6*
Total	250	199	4	195	78.0**

Notes: \*Percentage of UQ to QD of each group of respondents; \*\* Percentage of total UQ to total QD. QD = questionnaire distributed; QR = questionnaire received; IQ = unusable questionnaire; UQ = usable questionnaire.

Table 1 shows that a total of 250 questionnaires were disseminated and 199 questionnaires were received. It has been noted that “If a substantial number of questions - say, 25% of the items in the questionnaire - have been left unanswered, it may be advisable to throw out the questionnaire and not excluded it from the data set for analysis” (Sekaran, 2006). Therefore, 4 unusable questionnaires were not considered in the analysis and thus the final usable questionnaires were 195 representing 78%.

## DATA ANALYSIS

To test the research hypotheses formulated earlier in this study, the analysis of the data collected was carried out on two various levels: the first, for the overall sample; the second, for the various sub-groups. Demographics were done according to respondents’ occupation, experience and education. The SPSS technique was used in the analysis of the survey data. Along with the descriptive statistics, which mostly depend on the percentages, the mean, and the standard deviation, a statistical analysis was provided using a number of non-parametric tests such as the Chi-square Test, the Kruskal-Wallis Test and Univariate analysis.

These statistical tests were utilised to test for significant differences for the overall sample and between various sub-groups. As the data collected for this study were mainly nominal and ordinal data, it was decided to use the non-parametric tests that many statisticians (Bryman & Cramer, 2000; Pallant, 2013; Siegel & Castellan, 1988) have recommended to be used in such cases. For instant, Pallant (2013) stated that non-parametric tests are ideal for use when a researcher has data that is measured on nominal (categorical) and ordinal (ranked) scales.

### **Data Collection**

This study implicated the questionnaire survey to gather information from the sample on the impact of providing NAS on auditor independence and audit quality. The questions included in this survey are provided in the Appendix. The questionnaire includes two parts: Part A: contains demographic information about the respondents. Part B: contains 3 sections that include questions related to audit and NAS. These sections are; Section 1: Independence of auditor is impaired by providing NAS, Section 2: Audit quality is improved and enhanced by rendering NAS, and Section 3: The provision of NAS has no impact on auditor independence.

Most questions are based on a 5 point Likert scale. They are ranging from 1 to 5, where 1 refers to strongly disagree and 5 refers to strongly agree. One open-ended question was also included to gather respondents' opinions on the issue of the study. Companies listed in Bahrain Bourse and audit firms are covered in this study. By end of 2014, the total number of companies listed was 47 (Bahrain Bourse, 2014).

## **FINDINGS**

### **Description of the Sample**

Table 2 describes the sample in details. Regarding the experience and the education variables, the results in the table shows that about 95% of the respondents have BSc, Masters or PhD which means that the population have knowledge and experience and they can provide valuable information for the study. Also, the results in Table 2 shows that 58.4% of the respondents have experience of 5 years or above which means that the respondents have enough experience and thus can add important information to be used in the study.

Table 2  
*Details of usable questionnaire in sample groups*

Variable	Number of respondents	%*
Occupation		
Auditors	99	50.8
Accountants	54	28.2
F. Managers	42	21.0
Total	195	100
Experience		
Less than 5 years	81	41.6
5–10 years	69	35.4
10–15 years	19	9.7
More than 15 years	26	13.3
Total	195	100
Education		
Below BSc	10	5.1
BSc	114	58.5
Masters or Professional Degree	53	27.2
PhD	18	9.2
Total	195	100

Note: \* = Percentage of UQ in a specific group to total UD of the groups.

### **The Overall Sample**

Table 3 shows the descriptive statistics and the Chi-square results for each group of questions. The Chi-square for one sample test was adopted to test for significant differences in respondents' choice of answers on these groups of questions. In other words, it was employed to see if any choice of answer was favored significantly more than the others.

Table 3 shows that Section 1 of questions has a mean score of 3.821 with a standard deviation of 0.819 which is less than half of the mean which reveals that there is no dispersion among respondents' perceptions regarding this group of questions. The above result indicates that respondents are supporting the idea that independence of auditor is impaired by providing NAS. This result is supporting what was reported earlier in the literature. For instance, the above result is supporting what was reported in Bahrain by Joshi et al. (2007) who indicated that independence is impaired if the auditor renders NAS. In the light

of the above finding, it can be concluded that the issuance of the Bahraini CGC in 2011 improved, or at least protected, respondents' awareness of the auditor's independence in the Bahraini environment.

Moreover, the above result is consistent with a number of previous studies outside Bahrain. The result is in line with what was reported by Causholli et al. (2015) who found a strong evidence that audit quality suffers when clients are willing to purchase future NAS from their auditors. It is also in agreement with what was reported by Quick and Warming-Rasmussen (2005) who found that providing of NAS impairs auditor independence; and by Chukwunedu and Okafor (2014) who found that the NAS impair audit independence and audit objectivity. Furthermore, the above finding is in line with other previous studies in this area of research (Knapp, 1985; Mitchell, Sikka, Puxty, & Wilmott, 1993; Krishnan et al., 2005; Sori & Karbhari, 2006; Sori et al., 2010). These previous studies concluded that the provision of NAS impairs audit independence and audit objectivity. As a final outcome on this section of questions, the result of this study is in line with earlier conclusions reported by previous research accomplished in Bahrain or in other countries, including the more recent previous studies as all are supporting the idea that independence of auditor is impaired by providing NAS. This would suggest that the market perceives that auditor independence is at risk when providing NAS to the same audit client.

Concerning Section 2 of questions, Table 3 shows that it has a mean score of 3.424 with a low standard deviation of 0.632 which is also less than half of the mean. This result indicates that respondents support the idea that audit quality is enhanced and auditor objectivity is improved if NAS were provided by the auditor. The above result is consistent with most previous studies (Hartley & Ross, 1972; Goldman & Barlev, 1974; Glezen & Millar, 1985; Gul, 1989; Wallman, 1996; Antle et al., 1997; Arrunada, 1999; Sawan et al., 2013). These results can be justified since the auditor's awareness and knowledge of the client's company would be improved by the provision of NAS, leading to increase objectivity and independence (Goldman & Barlev, 1974); that providing NAS would lead to improve audit quality (Antle et al., 1997); or that the auditor provision of NAS to their audit clients decreases total costs, increase technical competence and motivates more intense competition (Arrunada, 1999).

Regarding Section 3 of questions, Table 3 indicates that Section 3 of questions has a low mean score of 2.955 with standard deviations of 0.8474 which is also less than half of the mean. It is clear that this section of questions, which is about the idea that providing NAS has no effect on auditor independence, has the lowest mean score among the three sections of questions. This result indicates

that respondents marginally support the above idea. The above result is consistent with most previous studies (Bloomfield & Shackman, 2008; Carmona et al., 2015; Sobrinho & Bortolon, 2016; Zhang et al., 2016). For instance, it is in line with what was reported in Norway by Zhang et al. (2016), who concluded that providing of NAS does not suggest loss of independence; in Brazil by Sobrinho and Bortolon (2016) who concluded that the provision of NAS does not affect auditor independence.

As a general comment on the above results, the three groups of respondents included in this survey highly supported the argument that independence of auditor is impaired by providing NAS (Section 1 of questions) as it received the highest mean score. However, little support was found regarding the argument that the provision of NAS does not affect auditor independence which has the lowest mean score.

Table 3  
*Descriptive statistics and Chi-square results of sections of questions (the overall sample)*

Sections of Q	N	Min	Max	Mean	SD	Chi-Square	df	Asymp. Sig.
Section 1 (Q 1–11)	195	1.18	5.00	3.821	.8193	86.938	33	<b>.000</b>
Section 2 (Q 12–22)	195	1.55	4.73	3.424	.6319	93.067	28	<b>.000</b>
Section 3 (Q 23–26)	195	1.25	5.00	2.955	.8474	105.508	16	<b>.000</b>

Note: Asymp. Sig. = Asymptotic Significance; SD = Standard Deviation; Q = Question.

Furthermore, Table 3 shows that values of Chi-square were entirely significant for the three groups of questions at ( $p < 0.05$ ). Therefore, it is possible to conclude that respondents’ selection of answers were not equally distributed among the different levels of agreement on: “impairment of auditor independence as a result of providing audit and NAS (Section 1); “improving audit quality as a result of rendering NAS (Section 2); and providing NAS has no effect upon on auditor independence (Section 3). Based on the above, all of the first three alternative hypotheses (H1, H2 and H3) formulated earlier in this study are accepted and the null ones are rejected.

Table 4 shows the descriptive analysis (means and standard deviation for each of the 26 questions). For the purpose of this study, it is assumed that any question with a mean greater than 3 indicates the importance of the question. It appeared from the table that values of Chi-square for all questions were significant at ( $p < 0.05$ ). Consequently, it can be concluded that respondents’ answers for each of the 26 questions were not equally dispersed among the different levels of agreement. Furthermore, Q6, Q4, Q17, Q1 and Q22 respectively are the

most important questions since they have got the highest means (ranging from 4.21–3.85).

Table 4  
*Descriptive statistics and Chi-square results for each question (the overall sample)*

Questions	N	Min	Max	Mean	Std. Dev.	Chi-square	df	Asymp. Sig.
Q1	195	1	5	<b>3.87</b>	1.216	30.205	4	<b>.000</b>
Q2	195	1	5	3.68	1.252	19.128	4	<b>.001</b>
Q3	195	1	5	3.63	1.290	13.231	4	<b>.010</b>
Q4	195	1	5	<b>4.09</b>	1.180	46.513	4	<b>.000</b>
Q5	195	1	5	3.09	1.080	78.667	4	<b>.000</b>
Q6	195	1	5	<b>4.21</b>	1.255	46.256	4	<b>.000</b>
Q7	195	1	5	2.85	1.242	19.077	4	<b>.001</b>
Q8	195	1	5	3.56	1.156	47.795	4	<b>.000</b>
Q9	195	1	5	3.77	1.096	49.641	4	<b>.000</b>
Q10	195	1	5	3.70	1.204	30.000	4	<b>.000</b>
Q11	195	1	5	3.73	1.231	23.077	4	<b>.000</b>
Q12	195	1	5	3.54	1.150	34.359	4	<b>.000</b>
Q13	195	1	5	3.63	1.188	27.128	4	<b>.000</b>
Q14	195	1	5	3.37	1.034	66.923	4	<b>.000</b>
Q15	195	1	5	3.57	1.191	30.821	4	<b>.000</b>
Q16	195	1	5	2.81	1.171	34.308	4	<b>.000</b>
Q17	195	1	5	3.92	1.176	34.256	4	<b>.000</b>
Q18	195	1	5	2.99	1.149	35.333	4	<b>.000</b>
Q19	195	1	5	3.20	1.103	58.308	4	<b>.000</b>
Q20	195	1	5	3.13	1.159	42.769	4	<b>.000</b>
Q21	195	1	5	3.31	1.107	41.949	4	<b>.000</b>
Q22	195	1	5	<b>3.85</b>	1.111	57.179	4	<b>.000</b>
Q23	195	1	5	2.59	1.142	40.000	4	<b>.000</b>
Q24	195	1	5	3.26	1.142	35.744	4	<b>.000</b>
Q25	193	1	5	3.15	1.159	35.109	4	<b>.000</b>
Q26	195	1	5	2.82	1.199	26.923	4	<b>.000</b>

Of the 26 questions, 21 were perceived as important with mean scores above 3. Further, the standard deviations of these questions are less than half of the mean score for each which reveals that there is no dispersal among respondents’

perceptions regarding these questions. Other questions such as question 7, 16, 18, 23 and 26 were of lower importance as having mean scores of 2.85, 2.81, 2.99, 2.59 and 2.82 respectively. The table also shows the results of the statistical analysis for each question using Chi-Square. It reveals that values of Chi-square for all questions were significant at ( $p < 0.05$ ). Hence, it can be concluded that respondents' answers for each question were not equally dispersed among the different levels of agreement.

### **The Effect of Demographic Variables**

In this section, respondents' perceptions were analysed in relation to their occupation, experience and education. The purpose of this analysis is to investigate whether the differences in demographic features of respondents affect their perceptions on the topic of this study. In other words, this part of the study concentrates on describing the different study groups according to their occupation, education and experience, as this classification will help in determining whether or not any of the background variables relating to the profile of the respondents influences their opinions.

### **The Univariate Analysis**

The univariate analysis presents evidence on the relationship between the demographic variables and the three sections of the questions included in this study. Research hypotheses (H4, H5 and H6) are tested in this section of the study. Table 5 presents a number of significant associations and suggests that there is a potential for, at least, a number of hypotheses to be supported. For example, it shows that there is a significant positive association between occupation variable from one side and two sections of the questions in the study, namely, Section 1 (Independence of auditor is impaired by providing NAS) and Section 2 (Audit quality is improved and enhanced by rendering NAS) from the other, but there is no significant association with the Section 3 of questions (The provision of NAS has no impact on auditor independence). No significant association was found concerning the other two demographic variables, experience and education.

The above results revealed that there is no significant association between respondents' experience and education on the one hand and their perceptions on the other. These results are greatly significant ( $p < 0.01$ ). Based on the above, it can be concluded that two demographic variables of respondents are not associated with their perceptions, while occupation is the only variable that has a relationship with their perceptions. This clearly indicates that some demographic variables are affecting respondents' perceptions while others are not. Based on the above

findings, H4, is accepted for only Section 1 and Section 2 of questions, while it is rejected for third section of questions. Furthermore, H5 and H6 are rejected for all of the three sections of questions. The above result suggests that being auditors, accountants or financial managers has an influence on their perceptions only on “Independence of auditor is impaired with providing NAS” and “Audit quality is improved and enhanced if the auditor renders NAS”.

Table 5  
*Correlation coefficients*

	Experience	Occupation	Education	Group 1	Group 2	Group 3
Experience	1.000					
Occupation	<b>.197*</b>	1.000				
Education	<b>.370*</b>	.134	1.000			
Section 1	.004	<b>.293*</b>	.004	1.000		
Section 2	-.106	<b>.223*</b>	.041	<b>.348*</b>	1.000	
Section 3	-.123	-.021	-.044	.041	<b>.453*</b>	1.000

Note: \*Correlation is significant at 0.01 level (2-tailed).

### **The Kruskal-Wallis Test (Demographic Variables)**

The Kruskal-Wallis Test, a non-parametric test alternative to a parametric one way analysis of variance test, was used to examine the significant differences among the various groups of respondents. Tables 6, 7 and 8 show the results regarding occupation, experience and education groups. Table 6 reveals that there are statistically significant differences in perceptions of occupation groups concerning Section 1 and Section 2 of questions. This result confirms the univariate results which reported earlier. Results in Tables 7 and 8 refer that there are no significant differences between experience and education groups regarding respondent’s perceptions on all sections of questions. This result shows some consensus among experience and education groups on their perceptions. Generally speaking, the above results are in line with other results reported by previous surveys on the effect of demographic variables, experience and education, on respondents’ perceptions. Finally, it can be concluded that results of non-parametric tests confirm those of univariate analysis. All revealed that occupation is the only demographic variable which associated with respondents’ perception, while experience and education do not. Based on the above, it is clear that H5 and H6 are rejected, while H4, is accepted for Section 1 and Section 2 of questions.

Table 6  
*Statistical analysis of occupation groups*

Questions	Chi-Square	df	Asymp. Sig.
Section 1 (Q 1–11)	24.138	2	<b>.000</b>
Section 2 (Q 12–22)	10.127	2	<b>.006</b>
Section 3 (Q 23–26)	2.628	2	.269

Notes: Kruskal Wallis Test; Grouping Variable: Occupation.

Table 7  
*Statistical analysis of experience groups*

Questions	Chi-Square	df	Asymp. Sig.
Section 1 (Q 1–11)	.454	3	.929
Section 2 (Q 12–22)	4.681	3	.197
Section 3 (Q 23–26)	5.790	3	.122

Notes: Kruskal Wallis Test; Grouping Variable: Experience.

Table 8  
*Statistical analysis of education groups*

Questions	Chi-Square	df	Asymp. Sig.
Section 1 (Q 1–11)	.133	3	.988
Section 2 (Q 12–22)	1.493	3	.684
Section 3 (Q 23–26)	1.401	3	.705

Notes: Kruskal Wallis Test; Grouping Variable: Education.

## CONCLUSIONS

This study investigated perceptions of three groups working in the Bahraini firms namely, auditors, accountants and financial managers, on the influence of providing NAS to audit clients on auditor independence and audit quality. A questionnaire was designed, developed and distributed to a sample of 250 respondents to gather information needed for testing the hypotheses of the study. One hundred and ninety-five (195) or 78% useable questionnaires were received. One of the main findings was that respondents are supporting the ideas that independence of auditor is impaired by providing NAS; and audit quality is improved and auditor objectivity is enhanced if the auditor renders NAS. Furthermore, they marginally support the idea that providing NAS has no effect on auditor independence. The descriptive analysis shows that of the 26 questions, 21 were perceived as important with high mean scores which is ranging from 4.21 to 3.13 and only few

questions were perceived as unimportant. Chi-square values for all questions were significant at ( $p < 0.05$ ) indicating that respondents' answers for each question were not equally distributed among the different levels of agreement. Kruskal-Wallis Test, which confirmed the univariate analysis, revealed that respondents' occupation is associated with their perceptions only on the first and the second sections of questions.

Concerning theoretical implications, this study contributes to the extant literature on the effects of providing non-audit services upon auditors' independence and audit quality in Bahrain, which considered as an important subject for both auditing firms and auditing profession. Regarding practical implications, this paper provides insights on the factors which explain the impact of the provision of non-audit services upon auditor independence and audit quality in Bahrain. Providing empirical evidence on this issue within the Bahraini environment, as a member of the Gulf Cooperation Council countries, may add a new dimension to the accounting and auditing literature.

This study is limited to respondents in listed companies working in Bahrain. Then the question raised is how the situation would be formed in case of privately held companies are another venue for a future research. Also in order to generalise the findings of the study, there is a need to conduct a similar study over long period of time. Other factors can be considered in implementing the study such as the economic conditions of the country. Findings of this research may not be generalised to other countries at diverse stages of development, or with varied business environments and cultures.

Future research could be conducted to investigate this important issue of research in other developing countries in general and GCC countries in particular. Other respondent groups such as external auditors, shareholders, regulators and members of the audit committees can be included in a future study.

## APPENDIX

### Questions included in the survey

Q. No.	Statement
<b>Group 1: Independence of auditor or audit quality is impaired with providing NAS.</b>	
1	Provision of NAS impairs the independence of the auditor or audit quality.
2	An auditor who provides NAS is more willing to give an unqualified opinion of the client's financial statements.
3	When providing NAS, auditors often gain a close relationship with management that can cause a situation where the auditors take sides with the client instead of following regulations.
4	The globalization in accounting and assurance service has created 'the multidisciplinary nature of large audit firms' which would offer audit and NAS to audit clients and this became one of the major issues regarding the potential auditor independence dilemma.
5	Income from NAS could make an audit firm economically dependent on an audit client, and in turn this might reduce the auditor's willingness to challenge possible misstatement of a client's financial statements.
6	An auditor should not be allowed to participate in the foundation of the corporation that is being audited by him or to be a member of administrative or advisory position.
7	There should be outright ban or prohibition on accounting firms providing consulting and other services to their audit clients.
8	Auditors are willing to sacrifice their independence or audit quality in exchange for retaining the audit clients from which they might accrue large NAS revenues.
9	Auditor independence or audit quality might be adversely affected by the provision of NAS if those services are perceived as escalating the economic bond between auditors and their clients.
10	Provision of audit and NAS would cause unfair competition due to the use of audit services to sell NAS, and believed that auditors should be banned from offering both services to the same client.
11	With the provision of NAS, auditors would not perform their audit services objectively and that the provision of NAS would impair perceived independence or audit quality because ultimately they would be auditing their own work or acting as management.
<b>Group 2: Audit quality is improved and auditor's objectivity and independence are enhanced, not impaired, if the auditor renders NAS.</b>	
12	The provision of NAS is expected to improve the firm's competitiveness, to maintain continuous growth and to satisfy customers.
13	The majority of NAS supplied by auditors is accounting services that facilitate listed companies to conform to the legal and regulatory requirements rather than management consultancy.
14	The provision of NAS activities enhance the auditor's ability to learn more clients, thereby helping to ensure that they satisfy their obligation to conduct a better audit.

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<b>Q. No.</b>	<b>Statement</b>
15	The provision of NAS positively enhance auditor independence and/or audit quality and on the other hand improve clients' operations.
16	The basis of banning non-audit work should be the size of the fees.
17	The basis of banning non-audit work should be the nature of the work.
18	The provision of NAS reduces total costs and increase technical competence.
19	The provision of NAS has a positive impact on the effectiveness of the audits.
20	Certain frauds might have been prevented or detected if NAS had been provided to the client or if better communication had occurred between NAS personnel and the audit engagement team.
21	Disclosure of NAS fees would enhance perceived auditor independence or audit quality.
22	Auditor's knowledge of the client company would be improved by the provision of NAS.
<b>Group 3: The provision of NAS has no effect on auditor independence.</b>	
23	The service of accounting systems design provided by auditors to audit clients has no threat to auditor independence or audit quality.
24	J The provision of NAS does not necessarily damage auditor independence or the quality of NAS.
25	The provision of NAS is considered to be minor threat to auditor independence or audit quality.
26	There is no influence of providing NAS on perceptions of independence or audit quality.

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