

# Auditor's Fear of Losing a Client: Views of Professional Accountants in the Big Audit Firms in Botswana

Christian J Mbekomize\* and Rhodgers Hove\*\*

---

*The objectives of this study are to explore the causes of auditors' fear of losing a client and to establish acceptable remedies according to practitioners in big audit firms in Botswana. A questionnaire was used to solicit the views of respondents, and descriptive statistics were computed. The findings of this study revealed that auditors in big firms are not concerned with the possibility of losing a client in case they issue an opinion that is unpleasant to the management. The study also revealed that the most acceptable remedy to mitigate the fear of losing a client was the creation of a Public Companies Accountancy Oversight Board to police the auditing firms and the appointment of an effective audit committee to deal with all auditing matters. The implications of these findings are that standards, statutes and regulations that are currently in place to ensure the integrity of auditors' work are adequate if they are accompanied by a more effective enforceability mechanism.*

---

## Introduction

The environment within which the financial statements audit is conducted is a complex arena built on inherently fragile foundation. Goldman and Barlev (1974) noted that the audit function in which the auditor examines the financial statements of an entity and reports on their adherence to the generally accepted accounting principles has innate conflict of interests between the firm and the auditor; between the shareholders and the management; and between the auditor's own self-interests and professional standards. They argued that auditors naturally find themselves under pressure to design their opinion not in accordance with the auditing standards, but in a manner that will reflect what the shareholders and management desire. Goldman and Barlev (1974) emphasized that the entity has power over the auditor because it can hire and fire him freely, it sets his audit fee and determines his working conditions. In acknowledging the complexity of the audit environment, Ronen (2002, p. 9) pointed out, "in the current social arrangement, auditors operate under perverse incentives: they are paid by the companies they audit and hence they are beholden to the Chief Executive Officers and Chief Finance Officers who ultimately decide on the hiring of their services."

---

\* Lecturer, Department of Accounting and Finance, University of Botswana, Private Bag UB 00701 Gaborone, Botswana. E-mail: mbekomizecj@mopipi.ub.bw

\*\* Lecturer, Department of Accounting and Finance, University of Botswana, Private Bag UB 00701 Gaborone, Botswana. E-mail: Rhodgers.Hove@mopipi.ub.bw

Along the same argument, Reiter and Williams (2004) observed that in an audit environment, the client hires the auditor and pays the fees but the auditor is supposed to conduct the audit in an independent fashion adhering to the auditing profession's covenant with the society—to audit in the interest of the public. In support of this, Moore *et al.* (2006) contend that like other professionals such as doctors and even politicians, auditors are subjected to moral seduction, whereby, they find themselves unaware of the gradual accumulation of pressures on them to bend their opinions. Unfortunately, due to motivated reasoning and self-serving biases, professionals attempt to justify their slanted conclusions. Moore *et al.* (2006) concluded that moral seduction of the accounting profession has its roots from three sources: (1) the management hiring and firing auditors at will; (2) auditors becoming employees of the clients; and (3) auditors providing non-audit services.

Paradoxically, in such an environment, the auditor is still expected to design audit programs, perform audit procedures and form audit opinion independently. It is this expectation from the financial community that the auditor would maintain total independence from the client at all times that has over the years bolstered the credibility of financial reporting and in turn propelled capital formation process. However, the number of business and audit failures that have befallen the world in the past decade in the likes of Enron, Worldcom, Adelphia and Xerox, have left the business world stunned as to what could be wrong with the accounting profession. Although these business collapses could not be attributed to a single factor, Ronen (2002) submitted that misaligned incentives of the auditors was the critical cause.

Botswana, a Southern African country with a population of around 2 million and per capita GDP of \$13,100 in 2010 (Information Technology Associates, 2011), has recorded the highest growth rate among the developing countries of an average of 9% over the past three decades before dropping to 7% in 2007 and to -3% in 2009. Its growth rate is now on recovery, and it is expected to average 6% in 2011 and 2012 (Travel Document Systems, 2011). One of the industries that have supported this remarkable economic growth in the country is the auditing industry that has played the role of enhancing public confidence to use corporate financial information to make economic decisions. In the period of economic glory, no major business failures have been reported in Botswana except the liquidation of Lobtrans (Pty) Ltd. in 2008 (Piet, 2008). Although no reported business failure has been connected to audit failure in Botswana, the likelihood of this happening in future cannot be ruled out. It may be argued that because a greater portion of audit market in Botswana is in the hands of the big four audit firms which operate as members of the international network firms, controlled by the western world that has experienced a number of business failures linked to audit failures, the contagion effect may rub on the sister firms in Botswana. It would be expected that the higher the likelihood of audit failures connected to business failures, the higher the chances of fear of losing a client.

Moreover, since July 2007 when the new Companies Act came into effect in Botswana, the audit market might have shrunk and competition increased due to expanded audit threshold. According to Section 191 of the Companies Act, the private company whose total assets are

less than P2 million, annual turnover is less than P5 million and has no company as its shareholder, is exempt from statutory audit. This leaves a significant number of companies outside the ambit of audit which increases competition among the auditing firms. This has the potential of heightening the auditor's fear of losing a client.

Another factor that may have a negative bearing on the auditor's fear of losing a client in Botswana is the fact raised by the Report on the Observance of Standards and Codes (ROSC) (2006) for the Republic of Botswana (World Bank, 2006). The report noted that the failure of many professional accountants to take professional liability insurance has the potential of limiting auditor's accountability and creating an environment of unconcern towards risks of malpractice suits by auditors. In the environment of non-existence of litigation against the auditor, the auditor's fear of losing a client is expected to be minimal. Against this background of possibility of higher level of fear of losing a client due to increased competition and likelihood of no fear due to history of nil audit litigations, the current study seeks to establish the existing position of auditor's fear of losing a client among audit practitioners in Botswana.

## Literature Review

### Financial Interests in Audit Client

Many researchers observed that the major impediments to auditors' independence stem from money issues. The auditors' fear of losing clients who pay audit fee and/or non-audit fees has been argued to have a huge impact on the auditors' judgment. When investigating the causes of unethical behavior among the South African auditors in small audit firms, Hefer (2009) found that among money and practice-related factors causing the auditor to act unethically, fear of losing clients was paramount factor. Ronen (2002) concluded that the fear of losing an indefinite stream of future audit fees effectively guarantees that the auditor complies with the management's wishes. Goldman and Barlev (1974) noted that the likelihood of losing the audit fee may be a much greater cause for conflict between professional integrity and self-interests. Tackett *et al.* (2004), in showing the risks related with non-audit fees, observed that greater economic harm is felt in situations where the audit firm loses an audit client from whom significant consulting fees plus normal audit fee were being received than losing a client with no related consulting fees.

In a study by Moyes and Anandarajan (2006), the auditor's fear of losing a client to a competitor auditor was found to be among the five conditions that may contribute to the problem of impaired auditor independence. In a study that examined the effect of independence threats and litigation on the auditors' evaluation of information leading to a going-concern reporting decision, Blay (2005) found that auditors facing high independence threats (fear of losing the client) evaluated information as more indicative of a surviving client and were more likely to suggest an unmodified audit report with client preference. Fearnley *et al.* (2005), in the study that looked at reconceptualization of auditor independence and audit risk, recommended, among others, the inclusion of fear of losing a client as the key threat to independence. When investigating the factors that cause the auditor to do more ground work

before accepting the audit engagement, Anorld *et al.* (1999) found that fear of losing the client was the second most important factor.

Falk *et al.* (1999) found, in an experiment carried out with students, that the biggest threat to independent behavior was the risk of losing a client. This was consistent with Beattie *et al.* (1999), who found that the two most frequently cited factors which were perceived to undermine the auditors' independence were partner's income depending on the retention of a specific client and 10% or more of the firm's total revenues coming from one client.

Provision of Management Advisory Services (MAS) to the audit clients has turned out to be the main source of income to auditing firms and it is presumed to have heightened the auditors' fear of losing the clients who sustain their livelihood. From 1993 to 2000, the percentage of consulting services fees to total revenues of the big audit firms had grown from 32% to 50% (Defond *et al.*, 2002; and Xu and Wang, 2008).

The debate as to whether or not the provision of MAS to the audit client impairs the auditors' independence has not yielded conclusive results. In the early 1960s, the American Institute of Certified Public Accountants (AICPA) issued the opinion stating that "there was no likelihood of conflict of interest arising from the offering of management advisory services" (Xu and Wang, 2008). The dilemma has been that the MAS are required by the clients, and they can be provided cheaply by the auditors who happen to have the requisite expertise, but supplying them to audit clients generates conflict of interest threats (Public Oversight Board, 2002). The proponents of the joint supply of audit and MAS argue that it creates efficient activities as it reduces transaction costs on the part of the client and provides the knowledge base for either service on the part of the auditors, and thus reducing audit costs (Simunic, 1984).

Several studies failed to find any significant relationship between the provision of management services and impaired independence (Barkess and Sminett, 1994; Craswell, 1999; and Defond *et al.*, 2002). They support the view that auditors will not do something intentionally to compromise their independence because the resultant loss of reputation and litigation costs outweigh the benefits derived from compromising with the auditor's independence.

The opponents of joint supply of audit and MAS raise the concern that in these circumstances there is no way that the auditor can completely avoid conflict of interests. Metcalf Committee (1977) and Panel on Audit Effectiveness (Public Oversight Board, 2002) reported that the supplying of both services to the same client can create a conflict of interests.

In summary, for a long time, direct or indirect financial interests, or personal relationships between clients and auditors have been identified as key threats to auditor's autonomy.

### **Measures to Enhance Auditors' Independence**

Different scholars, professional bodies as well as regulating bodies have attempted to provide some solutions to resuscitate the seemingly deteriorating auditors' independence resulting from the fear of losing clients. The following are some of the remedial measures highlighted by various contributors who seek to uplift the auditors' independence to the level it is supposed to be in the public eyes.

In their quest to improve the relationship between auditors and their clients, Goldman and Barlev (1974) suggest the following ways of increasing the auditors' power and subsequently their independence:

- Making replacement of auditors by the companies more difficult by prescribing a mandatory rotation of auditors.
- Establishment of audit committee in every publicly owned company.
- Reducing the flexibility in the financial reporting standards.
- Expanding the auditors' liability to third parties by allowing the foreseeable group to bring the case against the auditor in case of ordinary negligence.
- Allowing the auditors to continue providing consulting services in order to increase their power, but restricting their involvement in the actual decision-making process.
- Making auditors the employees of the public whereby the public is represented by the government or another public body.

After the Enron debacle, the USA Congress passed the Sarbanes-Oxley Act (SOX) in 2002 to govern the publicly held companies and their auditors. The main suggestions of the SOX that have a bearing on the auditor's independence are as follows:

- Establishment of the Public Company Accounting Oversight Board (PCAOB);
- Appointment of an audit committee to hire and fire the auditors;
- Broadening the criminal penalties and protection for whistleblowers; and
- Prohibiting auditors from providing consultancy in certain areas (Tackett *et al.*, 2004).

## Problem Statement

The fact that in practice management of the reporting entity has power to hire, pay and fire the auditor together with the rampant audit failures have heightened the concerns from the financial community regarding the possibility of the auditor acting under pressure when forming the audit opinion to please the client's management. There is a good amount of evidence pointing to the fact that fear of losing a client greatly influences the auditor's opinion. This study seeks the views of auditors regarding the nature, cause and remedies of auditor's fear of losing a client.

## Objectives of the Study

The specific objectives of this paper are:

- To establish the views of auditors concerning the nature and causes of auditor's fear of losing a client.
- To establish acceptable remedies to the fear of losing clients according to auditors.

- To establish whether from the auditors' viewpoint, clients get concerned when a modified opinion is issued.
- To establish the action the client can take against the auditor after getting a modified report.
- To find the extent of protection accorded to the auditor by the existing laws in Botswana.

The paper presents a literature review on the subject matter, highlights the methodology of the study, analyzes the respondents' data, discusses the findings, and lays down the conclusions and recommendations.

## Methodology

### Population and Sample

The population for this study comprised audit partners ( $N = 21$ ) and audit managers ( $N = 42$ ) in the five big auditing firms in Botswana—Ernst and Young, Deloitte, Grant Thornton, KPMG and PricewaterCoopers. These firms were selected because they are considered big in terms of their revenues and number of partners and employees. We targeted the big firms on the conviction that small audit firms do not have the same level of fear of losing a client like the big firms which are considered to be more financially stable. The target sample was 15 subjects, aiming at three subjects from each firm. Because the questionnaires were distributed on the basis of prospective respondent's willingness to complete the questionnaire after telephonic requests, only 12 questionnaires were administered.

### Instrument

A self-completion questionnaire comprising nine questions was used. Two questions were about the size of the company in terms of number of partners and employees; and the position of the respondent in the firm. The other three questions looked at clients' concerns about modified opinions, alternative course of actions available to them when they receive a qualified opinion and auditors' legal protection against management's pressure. The two key questions which were derived from literature had groups of statements, one group with 12 items referring to the nature and causes of auditor's fear of losing a client, and the other group with eight items focusing on remedies to address the fear of losing a client. One open-ended question was added to each of the key questions requesting for other causes or remedies. Apart from the open-ended questions and respondents' background questions, the rest of the questions were Likert-type questions ranging from a three-point scale to a five-point scale. One key question on the nature and causes of auditors' fear of losing a client required respondents to indicate their agreement or disagreement to the statements provided using a 5-point Likert measure anchored by 'strongly agree' on high end and 'strongly disagree' on the low end. Another key question about the measures to reduce the fear of losing a client asked the respondents to indicate the degree of suitability of each measure using a 4-point Likert scale with probability levels of most suitable (4), suitable (3), unsuitable (2) and most unsuitable (1).

Respondents were contacted by telephone and given an alternative to be interviewed by the researcher whereby the researcher would fill the questionnaire as they respond, or be left with a questionnaire and return it within a week. Almost half of the respondents preferred to be interviewed.

## Data Analysis

Out of the 12 questionnaires distributed, 11 usable questionnaires were received and analyzed using Statistical Package for Social Sciences (SPSS). Out of the 11 respondents, three were partners and eight were managers.

### Causes of Fear of Losing a Client

Table 1 presents the respondents' views regarding the nature and causes of the auditor's fear of losing a client. From the table it is clear that according to the respondents, auditors are least concerned with the likelihood that they may not be reappointed if they issue an opinion that does not favor client's management. All respondents except one (90.9%) disagreed with a statement which suggested that the idea of losing a client lingers in the auditor's mind when considering the type of opinion to give. However, 82% of respondents agreed that competition from other auditing firms would make it more likely for the auditors to fear losing clients. Also, the respondents did not agree that inflexibility of accounting and auditing standards,

| S. No. | Statements on Auditor's Fear of Losing a Client                                                                                   | SA (%) | A (%) | N (%) | D (%) | SD (%) | Mean |
|--------|-----------------------------------------------------------------------------------------------------------------------------------|--------|-------|-------|-------|--------|------|
| 1.     | Losing a client is an issue when auditor is considering type of opinion to issue.                                                 | 9.1    | –     | –     | 54.5  | 36.4   | 1.91 |
| 2.     | Management pressure for the favorable audit opinion contributes to the fear of losing a client.                                   | 9.1    | –     | 27.3  | 36.4  | 27.3   | 2.27 |
| 3.     | Auditor's own incompetence causes auditor's fear of losing a client.                                                              | 9.1    | 18.2  | –     | 54.5  | 18.2   | 2.45 |
| 4.     | Auditor's self-enrichment as well as benefits to the auditing firm contributes to the fear of losing a client.                    | 27.3   | 27.3  | 9.1   | 18.2  | 18.2   | 3.27 |
| 5.     | Inflexibility of ISA and IFRS put the auditor under pressure and thus, influence the auditor's fear of losing a client.           | –      | 18.2  | 9.1   | 45.5  | 27.3   | 2.18 |
| 6.     | Provision of Management Advisory Services to audit client contributes to the fear of losing a client.                             | –      | 18.2  | 18.2  | 54.5  | 9.1    | 2.45 |
| 7.     | Fear of losing a client will be more intense when the auditor receives more consultancy fee than audit fee from the audit client. | 36.4   | 18.2  | 9.1   | 18.2  | 18.2   | 3.36 |

Table 1 (Cont.)

| S. No. | Statements on Auditor's Fear of Losing a Client                                                                                    | SA (%) | A (%) | N (%) | D (%) | SD (%) | Mean |
|--------|------------------------------------------------------------------------------------------------------------------------------------|--------|-------|-------|-------|--------|------|
| 8.     | The longer the duration of audit engagement, the more the likelihood of fear of losing a client.                                   | 9.1    | 9.1   | 18.2  | 45.5  | 18.2   | 2.45 |
| 9.     | Competition from other firms contributes to the fear of losing a client.                                                           | 18.2   | 63.6  | –     | 9.1   | 9.1    | 3.91 |
| 10.    | Small firms are more likely to have fear of losing a client than big firms.                                                        | 27.3   | 18.2  | 27.3  | 18.2  | 9.1    | 3.36 |
| 11.    | The need to balance the cost of audit and users' pressure for the quality audit report contributes to the fear of losing a client. | 9.1    | 36.4  | 27.3  | 9.1   | 18.2   | 3.09 |
| 12.    | The fact that in practice management hires and fires the auditor exacerbate the auditor's fear of losing a client.                 | –      | 45.5  | 9.1   | 27.3  | 18.2   | 2.82 |

auditors' own incompetence, management pressure, provision of MAS, and long duration of auditors' tenure of office induce auditor's fear of losing client. On the other hand, in addition to the competition from other firms, the respondents agreed that where the auditor receives more consultancy fee than the audit fee from the same client (54.6%) or where the auditor is driven by self-enrichment tendencies in his approach to auditing (54.6%), there is more likelihood of auditor experiencing fear of losing a client.

While 45.5% of respondents agreed that small auditing firms are more likely to have fear of losing clients than big firms, 27.3% of them disagreed with the statement and 27.3% of them where neutral. Interestingly, respondents were divided regarding the effect of client's management ability to hire and fire the auditor on the auditor's fear of losing a client if they give unacceptable opinion. While 9.1% of respondents were neutral on the statement, 45.5% of them disagreed with the statement and another 45.5% of them agreed. Regarding whether or not the need to balance costs with user's pressure for quality audit report influences auditor's fear of losing a client, a good number of respondents (45.5%) responded affirmatively, while 27.3% disagreed with the idea and another 27.3% could not commit themselves.

The following were the other causes for auditors' fear of losing a client as mentioned by respondents. The percentage in brackets indicate the number of respondents who stated the respective factor, and where there are no percentages, it means the factor was mentioned by one respondent.

- Provision of poor services and failure to honor commitments (27.3%).
- Auditors' rotation as required by government and parastatal organizations (27.3%).
- Loss of key staff in a team (18.2%).
- Depressed economic environment.



- Increased number of audit firms.
- Where a single client contributes significantly to the revenue of auditing firm.
- Auditing high profiled client.
- Change in organizational or ownership structure.

To the question whether or not clients get concerned when the auditor's report is modified, all the respondents gave the affirmative answer. However, to the question how often the management tries to convince the auditor to change the opinion, 45.5% of respondents said very often, 27.3% often and 27.3% rarely.

Another area of interest to this study was the alternative courses of action that can be taken by the client when the audit opinion is modified. While 45.5% of respondents were of the view that the client would move for non-reappointment of the auditor, 54.5% of them thought that the client would not take any action against the auditor because the modification was always justified. However, some respondents commented that the client' course of action would depend on the gravity of the causes of modification.

Regarding the question whether the auditors feel protected by existing statutes, standards and regulations, a majority of the respondents (72.7%) felt that the available protection was at a moderate extent, and 27.3% of them thought that it was at a greater extent. That implies that the auditors in Botswana are satisfied with the protection accorded to them to enable them perform the audit work freely.

## Remedies

Table 2 presents the views of the respondents regarding the suitability of some measures to mitigate the auditors' fear of losing client. Creation of a Public Company Accounting Oversight Board

| Table 2: Possible Remedies to Auditor's Fear of Losing a Client |                                                                                                                    |        |       |        |         |      |
|-----------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|--------|-------|--------|---------|------|
| S. No.                                                          | Possible Remedies                                                                                                  | MS (%) | S (%) | US (%) | MUS (%) | Mean |
| 1.                                                              | Creation of a Public Company Accounting Oversight Board to police the auditing firms.                              | 54.5   | 45.5  | –      | –       | 3.55 |
| 2.                                                              | Creation of an Audit Fund where companies will contribute a predetermined amount from which auditors will be paid. | 18.2   | 9.1   | 18.2   | 54.5    | 1.91 |
| 3.                                                              | Appointment of an audit committee that is free from management to be in charge of all audit-related matters.       | 54.5   | 45.5  | –      | –       | 3.55 |
| 4.                                                              | Imposing stricter penalties for officers involved in unethical practices and protection of whistle-blowers.        | 27.3   | 72.7  | –      | –       | 3.27 |
| 5.                                                              | Strict prohibition of auditors from providing MAS to audit clients.                                                | 30.0   | 50.0  | 20.0   | –       | 3.10 |

Table 2 (Cont.)

| S. No. | Possible Remedies                                                    | MS (%) | S (%) | US (%) | MUS (%) | Mean |
|--------|----------------------------------------------------------------------|--------|-------|--------|---------|------|
| 6.     | Mandatory rotation of auditors for a period of four to five years.   | 27.3   | 54.5  | 9.1    | 9.1     | 3.00 |
| 7.     | Expanding auditors' liability to third parties.                      | –      | 18.2  | 45.5   | 36.4    | 1.82 |
| 8.     | Creation of a public body to carry out auditing of public companies. | –      | 9.1   | 45.5   | 45.5    | 2.18 |

to oversee the activities of the auditing firms auditing public-owned companies and appointment of a more assertive audit committee which is free from management to be in charge of all audit-related matters in an organization were the most preferred measures by all the respondents with a mean score of 3.55 each. This could mean accountants' commitment to and support of the recently formed Botswana Accounting Oversight Authority (BAOA) which was established by the Botswana Financial Reporting Act (2010) to serve as an independent body to monitor the activities of the professional accountants.

Other measures that received a high level of acceptance as being suitable in making auditors more free to express their opinions without fear of management intimidation are: imposition of more strict penalties for officers involved in unethical behaviors and protection of whistleblowers. All respondents agreed to these remedies with a mean score of 3.27. Others included the strict prohibition of management advisory services to audit client which was consented to by 80% of respondents with 3.10 mean score; and mandatory rotation of auditors for a period of four to five years which was favored by 82% with a mean score of 3. Botswana Companies Act (2004) still provides for one year tenure of auditor's office but allows for almost indefinite reappointments.

An idea of creating an Audit Fund to which companies requiring audit will contribute a certain annual amount which will be used to pay audit fees was rejected by the respondents. Most respondents (73%) considered this new idea to be an unsuitable move with a mean score of 1.91. Some of those who rejected the idea stated that the creation of an audit fund will remove the business element in the whole process. They argued that appointing an auditor and accepting an engagement client are more of business decisions, although the public interests are to be considered when such decisions are made. Expanding auditor's liabilities to third parties, whereby all those investing in public could successfully sue the auditor for ordinary negligence, was also not favored by the respondents. A whopping 82% discarded the idea with a mean score of 1.82 being the lowest mean score. It is apparent that auditors do not want more responsibility on their shoulders than what they already have. Creation of the public body to audit the public companies was also denied as a measure to reduce auditor's fear of losing a client. One partner commented that implementation of such an idea will be going against contemporary trends which are supporting more privatization.

## Discussion

### Existence of Auditor's Fear of Losing a Client

Auditors in this study denied the existence of the fear of losing a client as a concern when forming an audit opinion but accepted that it may arise in the circumstances of high competition, provision of poor services, provision of MAS to the audit client, consultancy fees being higher than audit fee and one client being a significant contributor to audit revenue. These findings are consistent with the conclusions made by the studies that identified the likelihood of loss of the audit fee as a much greater cause for conflict between professional integrity and self-interests (Goldman and Barlev, 1974; Ronen, 2002; Tackett *et al.*, 2004). These results may be interpreted to mean that as the chances of losing significant financial gains from the client increase, the probability of the auditor acting inappropriately against professional standards and yielding to client pressure also increases.

### PCAOB and Audit Committee

The respondents have ranked highly the creation of the PCAOB and appointment of the audit committee as remedial measures to mitigate the likelihood of fear of losing client when forming an opinion. Effective running of PCAOB requires seasoned professional accountants who are capable of effectively monitoring the work of auditing firms. In Botswana, the newly established Botswana Accounting Oversight Authority is charged with, among others, the registering of the certified auditors and firms of Public Interest Entities (PIE), monitoring their services and professional conduct, ensuring quality financial reporting, keeping an eye on regulatory system of Botswana Institute of Certified Accountants (BICA), investigating suspected acts of misconduct and taking disciplinary actions (Financial Reporting Act, 2010). With challenges of shortage of accountants in Botswana, it may take some time for the authority to fully discharge its responsibilities unless concerted efforts are made to recruit enough qualified manpower to run the operations of its Board.

Audit committees which are completely divorced from the influence of management, and upon which all powers of appointing and firing the auditors are vested, have high potential of significantly boosting the auditors' independence. But they may not be able to fully eliminate the auditors' fear of losing the client as the auditors would still consciously or unconsciously wish to please the client to influence the next audit contract. It is highly unlikely that the Chief Executive Officer will completely ignore the auditor-appointment process, while the audit committee is supposed to be in constant liaison with the management. In our view, as long as the responsibility to appoint and pay the auditor is within the entity that is being audited, there will always be elements of fear.

### Strict Penalties and Protection of Whistleblowers

Respondents supported the idea of increasing punishments for persons in companies committing fraud and expanding the protection of whistleblowers in companies and auditing firms. These measures, if accompanied by stronger, fairer and independent legal system, will go a long way in deterring personnel in reporting entities and accounting firms from perpetrating fraud and

concealing it. Auditors will definitely and seriously consider the cost and benefits involved in the two courses of action: side with management and face jail term or speak the truth and face the possibilities of losing that client.

### **Provision of MAS**

Although previous studies have not conclusively linked provision of MAS to an audit client with issuing inappropriate opinions, the present study's respondents concurred with a move to curtail the number of consultancy services that can be provided as a measure to reduce auditor's fear of losing client. Although the provision of MAS has advantages and disadvantages to both the client and the auditor, we support the position of denying the auditors a chance of offering any type of services to the audit client other than assurances services. This would lead to the creation of consultancy firms which are separate from audit firms, thereby enhancing the auditors' independence.

### **Mandatory Rotation**

Again, respondents to this study assented that giving auditors a fixed period of between four and five years will enhance their freedom to give an unbiased opinion. This view was earlier on advocated by studies of Imhoff (2003), Tackett *et al.* (2004), Vanstraelen (2000) and Moore *et al.* (2006). However, respondents were divided concerning the current Botswana government's and parastatal organizations' practice of changing auditors regularly. We suspect that even with mandatory rotation of the audit firm, the fear of losing clients will continue to influence the auditors' judgment. Because of the possibility of being offered another term after the expiry of a certain fixed period, auditors may still be inclined to favor management. We however take a position that the route of mandatory rotation is worth pursuing in order to promote equity in the auditing profession and allow small auditing firms to grow.

### **Creation of Public Audit Company and Audit Fund**

Expectedly, respondents rejected the creation of a public audit company and an audit fund—initiatives intended to rid auditor-client relationship of financial interests. A reason advanced against the creation of audit public company was that the world is moving towards privatization. But this argument is negating the main purpose of auditing which is the protection of the public interests. The trust in the audit function has been based on the belief that the auditor can guard equally the public interests and the personal interests. Audit failures that have been happening have significantly made a dent on this trust. May be it is high time that auditors accepted the fact that this perceived trust is putting too much responsibility on their shoulders which is naturally unbearable, and accepted the measures which aimed at relieving them.

The audit fund was meant to assign the responsibility of choosing and paying the auditor to an independent body which is not the auditee. Companies legally required to be audited would contribute a certain amount annually to the fund, and the auditor who is appointed by the fund on behalf of the auditee would be paid by the fund. The respondents rejected the idea on the grounds, among others, that choosing the auditor and accepting the engagement are

business decisions which should be left to the auditee and the auditors to make. Creation of the audit fund will work against auditing firms which are operated as business entities. We argue that protection of the interests of external parties to the reporting entity should remain the central objective of the auditing function.

## Conclusion

This study sought the views of professional accountants in the big auditing firms in Botswana concerning the realities of auditor's fear of losing the client and the possible safeguards against such a risk. The findings suggest that the auditors in big audit firms are not concerned with the risk of losing the client to another audit firm when they are considering the type of opinion to issue. They however agree that fear would arise in conditions of high competition, provision of poor quality services and auditor's high revenue dependency on a single client. The most acceptable remedies were the establishment of the PCAOB and appointment of an effective audit committee. Creation of audit fund, expansion of auditors' liability to third party and establishment of a government-run audit company were rejected as means of reducing the likelihood of fear of losing the client. The present study also found that client's management is concerned when the audit opinion is modified, and in most cases they would like it changed, but they would not try to remove the auditor if the modification is justified.

**Recommendations:** We argue that measures intending to reduce the power of client's management over the auditor, such as creation of the audit fund which appoints and pays the auditor, should be given a serious consideration by legislators, if the audit profession has to maintain its precious characteristic of independence.

Auditors are satisfied with the protection accorded to them in professional standards and statutes; therefore, what is required is a more effective enforceability mechanism to ensure stringent adherence to the existing regulatory framework.■

## References

1. Anorld D F, Bernardi R A and Neidermeyer P E (1999), "The Effect of Independence on Decisions Concerning Additional Audit Work: A European Perspective", *Auditing: A Journal of Practice and Theory*, Vol. 18, No. 2, pp. 45-67.
2. Barkess L and Simnett R (1994), "The Provision of Other Services by Auditors: Independence and Pricing Issues", *Accounting and Business Research*, Vol. 24, pp. 99-108.
3. Beattie V, Fearnley S and Brandt R (1999), "Perceptions of Auditor Independence: UK Evidence", *Journal of International Accounting, Auditing and Taxation*, Vol. 8, No. 2, pp. 67-107.
4. Blay A D (2005), "Independence Threats, Litigation Risk, and the Auditor's Decision Process", *Contemporary Accounting Research*, Vol. 22, No. 4, pp. 759-789.
5. Botswana Companies Act (2003), "Act No. 32 of 2004", Government Printer, Botswana Government, Gaborone, Botswana.

6. "Botswana Financial Reporting Act (2010)", Government Printer, Gaborone, Botswana.
7. Craswell A T (1999), "Does the Provision of Non-Audit Services Impair Auditor Independence?", *Journal of International Auditing*, Vol. 3, No. 1, pp. 29-40.
8. DeFond M L, Raghunandan K and Subramanyam K R (2002), "Do Non-Audit Service Fees Impair Auditor Independence?: Evidence from Going Concern Audit Opinion", *Journal of Accounting Research*, Vol. 40, No. 4, pp. 1247-1274.
9. Falk H, Lynn S, Mestelman S and Shehata M (1999), "Auditor Independence, Self-Interested Behaviour and Ethics: Some Experimental Evidence", *Journal of Accounting and Public Policy*, Vol. 18, Nos. 4 & 5, pp. 395-428.
10. Fearnley S, Beattie V and Brandt R (2005), "Auditor Independence and Audit Risk: A Reconceptualization", *Journal of International Accounting Research*, Vol. 4, No. 1, pp. 39-71.
11. Goldman A and Barlev B (1974), "The Auditor-Firm Conflict of Interests: Its Implications for Independence", *The Accounting Review*, Vol. 49, No. 4, pp. 707-718.
12. Hefer J (2009), "The Perceptions of Registered Auditors: Ethical Problems and Experience", in Paliwal U L and Olivier M A (Eds.), *Contemporary Issues in Accounting and Finance*, University of Namibia, Windhoek.
13. Imhoff E A (2003), "Accounting Quality, Auditing, and Corporate Governance", *Accounting Horizons*, Supplement, pp. 117-128.
14. Information Technology Associates (2011), "Botswana Economy 2011", available at [http://www.theodora.com/wfbcurrent/botswana/botswana\\_economy.html](http://www.theodora.com/wfbcurrent/botswana/botswana_economy.html). Retrieved on July 12.
15. Metcalf Committee (1977), "The Accounting Establishment: A Staff Study", Subcommittee on Reports, Accounting and Management of the Commission on Government Operations, US Senate, Washington DC.
16. Moore D A, Tetlock P E, Tanlu L and Bazerman M H (2006), "Conflict of Interests and the Case of Auditor Independence: Moral Seduction and Strategic Issue Cycling", *Academy of Management Review*, Vol. 31, No. 1, pp. 10-29.
17. Moyes G D and Anandarajan A (2006), "CPAs' Perceptions of Factors Influencing the Quality of Financial Statements Audits: Substandard Performance and Impaired Independence", *Journal of Forensic Accounting*, Vol. 1524-5586/VII, pp. 133-162.
18. Piet B (2008), "Botswana: Lobtrans Liquidated", *Mmegi/The Reporter*, available at <http://allafrica.com/stories/200802041382.html>. Accessed on September 15, 2009.
19. Public Oversight Board (2002), "The Panel on Audit Effectiveness: Report and Recommendations", Public Oversight Board, Stamford, CT, available at <http://www.pobauditpanel.org/downloads/chapter5.pdf>. Retrieved on May 6, 2010.

20. Reiter S A and Williams P F (2004), "The Philosophy and Rhetoric of Auditor Independence Concepts", *Business Ethics Quarterly*, Vol. 14, No. 3, pp. 355-376.
21. Ronen J (2002), "Post-Enron Reform: Financial-Statement Insurance, and GAAP Re-Visited", *Stanford Journal of Law, Business & Finance*, Vol. 8, No. 1, pp. 1-30.
22. Simunic D (1984), "Auditing, Consulting, and Auditor Independence", *Journal of Accounting Research*, Vol. 22, No. 2, pp. 679-700.
23. Tackett J, Wolf F and Claypool G (2004), "Sarbanes-Oxley and Audit Failure: A Critical Examination", *Managerial Auditing Journal*, Vol. 19, No. 3, pp. 340-350.
24. Travel Document Systems (2011), "Botswana Economy", available at <http://www.traveldocs.com/bw/economy.htm>. Retrieved on July 14.
25. Vanstraelen A (2000), "Impact of Renewable Long-Term Audit Mandates on Audit Quality", *The European Accounting Review*, Vol. 9, No. 3, pp. 419-442.
26. World Bank (2006), "Report on the Observance of Standards and Codes (ROSC) Republic of Botswana", available at [http://www.worldbank.org/ifa/rosc\\_aa\\_bot.pdf](http://www.worldbank.org/ifa/rosc_aa_bot.pdf). Retrieved on April 15.
27. Xu Y and Wang K J (2008), "Whither the Public Accounting as a Profession: Historical Lessons of Auditor Independence", *Journal of Academy of Business and Economics*, Vol. 8, No. 4, pp. 127-136.

## Appendix

| <b>Research Questionnaire</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |                                                                                                                                   |                          |                          |                          |                          |                          |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| <b>Research Topic:</b> Auditor's Fear of Losing a Client: Views of Professional Accountants in the Big Audit Firms in Botswana                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                                                                                                                                   |                          |                          |                          |                          |                          |
| It has been observed that the major source of impediment to auditors' independence stems from money issues. The auditors' fear of losing clients who pay audit fee and/or non-audit fees has been argued to have a huge influence on auditors' judgment. We are conducting a research to establish the possible causes of auditors' fear and what could be acceptable remedies to reduce that fear of losing clients with view of enhancing auditors' independence. You are therefore kindly requested to complete the following questionnaire. The information you provide will be treated strictly confidential and will be used solely for the purpose of this research. |                                                                                                                                   |                          |                          |                          |                          |                          |
| 1. What is size of your audit firm?                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                                                                                                                                   |                          |                          |                          |                          |                          |
| Number of Partners                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                   |                          |                          |                          |                          |                          |
| Number of Employees                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                                                                                                                                   |                          |                          |                          |                          |                          |
| 2. What is your position in the firm?                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                                                                                                                   |                          |                          |                          |                          |                          |
| Partner                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |                                                                                                                                   |                          |                          |                          |                          |                          |
| Manager                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |                                                                                                                                   |                          |                          |                          |                          |                          |
| 3. Below are a number of statements about nature and possible causes of auditors' fear of losing clients. Kindly indicate your agreement or otherwise to each of the statements.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                                                                                                                                   |                          |                          |                          |                          |                          |
| <b>Note:</b> SA = Strongly Agree, A = Agree, N = Neutral, D = Disagree, SD = Strongly Disagree                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                                                                                                                                   |                          |                          |                          |                          |                          |
| S. No.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | Statements about Nature and Possible Causes of Auditor's Fear of Losing Client                                                    | SA                       | A                        | N                        | D                        | SD                       |
| 1.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Losing a client is an issue when auditor is considering type of opinion to issue.                                                 | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Management pressure for the favorable audit opinion contributes to the fear of losing a client.                                   | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Auditor's own incompetence causes auditor's fear of losing a client.                                                              | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Auditor's self-enrichment as well as benefits to the auditing firm contributes to the fear of losing a client.                    | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 5.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Inflexibility of ISA and IFRS put the auditor under pressure and thus influence the auditor's fear of losing a client.            | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 6.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Provision of Management Advisory Services to audit client contributes to the fear of losing a client.                             | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 7.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Fear of losing a client will be more intense when the auditor receives more consultancy fee than audit fee from the audit client. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 8.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | The longer the duration of audit engagement, the more the likelihood of fear of losing a client.                                  | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |



## Appendix (Cont.)

| S. No. | Statements about Nature and Possible Causes of Auditor's Fear of Losing Client                                                     | SA | A | N | D | SD |
|--------|------------------------------------------------------------------------------------------------------------------------------------|----|---|---|---|----|
| 9.     | Competition from other firms contributes to the fear of losing a client.                                                           |    |   |   |   |    |
| 10.    | Small firms are more likely to have fear of losing a client than big firms.                                                        |    |   |   |   |    |
| 11.    | The need to balance the cost of audit and users' pressure for the quality audit report contributes to the fear of losing a client. |    |   |   |   |    |
| 12.    | The fact that in practice management hire and fire the auditor exacerbate the auditor's fear of losing a client.                   |    |   |   |   |    |

4. What are other causes of auditor's fear of losing a client?

-----

-----

-----

-----

-----

5. (i) Do clients get concerned when the audit report is modified? Yes  No

(ii) If Yes, How often do they try to convince the auditor to change the opinion?

Very often  Often

Rare  Very rare

6. What action, if any, can a client take against the auditor after getting a modified report?

Non-Reappointment  Terminate the contract

No action against the auditor

Any other .....

7. To what extent do you think the existing laws in Botswana (e.g., Companies Act) protect the auditors against client's management pressure:

To a great extent  To a moderate extent

Not at all

8. Below are a number of measures that have been proposed to enhance auditors' independence and therefore reduce the extent of fear of losing a client. Kindly indicate your opinion about the suitability or otherwise of each measure in reducing auditors' fear of losing a client when expressing audit opinion.

## Appendix (Cont.)

| S. No.                                                                                                                                                                                                    | Remedial Measures                                                                                                  | MS                       | S                        | US                       | MUS                      |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| 1.                                                                                                                                                                                                        | Creation of a Public Company Accounting Oversight Board to police the auditing firms.                              | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2.                                                                                                                                                                                                        | Creation of an Audit Fund where companies will contribute a predetermined amount from which auditors will be paid. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3.                                                                                                                                                                                                        | Appointment of an audit committee that is free from management to be in charge of all audit-related matters.       | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4.                                                                                                                                                                                                        | Imposing stricter penalties for officers involved in unethical practices and protection of whistleblowers.         | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 5.                                                                                                                                                                                                        | Strict prohibition of auditors from providing MAS to audit clients.                                                | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 6.                                                                                                                                                                                                        | Mandatory rotation of auditors for a period of four to five years.                                                 | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 7.                                                                                                                                                                                                        | Expanding auditors' liability to third parties.                                                                    | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 8.                                                                                                                                                                                                        | Creation of a public body to carry auditing of public companies.                                                   | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| <p><b>Note:</b> MS = Most Suitable, S = Suitable, US = Unsuitable, MUS = Most Unsuitable.</p>                                                                                                             |                                                                                                                    |                          |                          |                          |                          |
| <p>9. Suggest other measures, if any, to create an environment where the auditor may issue a report without fear of losing a client.</p> <p>-----</p> <p>-----</p> <p>-----</p> <p>-----</p> <p>-----</p> |                                                                                                                    |                          |                          |                          |                          |

*Reference # 09J-2012-10-01-01*

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.