

PROHIBITION OF NON-AUDIT SERVICES AND ITS IMPACT ON THE COMPETITION BETWEEN LOCAL AUDITING FIRMS AND BIG-4 AFFILIATED AUDIT FIRMS IN BANGLADESH

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ABSTRACT

The study was conducted at the Department of Audit & Assurance to investigate the impact of the prohibition of certain non-audit services on the competition between local auditing firms and Big-4-affiliated auditing firms in Bangladesh. The approach selected for this research is a qualitative one and has a descriptive and explanatory nature. From this research it becomes evident that the Big 4 audit firms do not believe that top listed companies and or global companies in Bangladesh will appoint local big consultancy firms or smaller specialized auditing firms to conduct their non-audit services. However, they believe that it is possible for the big consultancy firms or smaller specialized auditing firms to enter audit market in Bangladesh. The findings of this study present an apparent picture of the field of auditing in Bangladesh and also could be used as financial reporting regulatory authorities. It will also guide the researchers for future investigations.

Keywords: Corporate Governance Order, Audit Services, Non-audit services, Competition and Local auditing firms.

INTRODUCTION

After the cases of Enron and WorldCom, in order to avoid accounting scandals and bring the trust back in audit profession the United States passed a new law known as the Sarbanes-Oxley Act (SOX, 2002). This law started operating on July 30, 2002. All American and foreign companies that have registered stocks for trading on all American stock exchanges have to follow the Sarbanes-Oxley Act. According to the section 201 of the Sarbanes-Oxley Act, an auditing firm cannot provide both audit and non-audit services to the same client. Auditing firms used to provide both audit services and non-audit services to their clients. So, the prohibition of the joint provision of audit and non-audit services must have some visible impact on audit firms and at the same time on the companies using both services. Though the audit market in Bangladesh is not as developed as it is in the USA, similar restrictions are already in place in Bangladesh by prohibiting non-auditing services of an audit firm.

Bangladesh Securities and Exchange Commission (SEC) issued a Corporate Governance Order (CGO) in 2006, which prohibited an audit firm from giving both audit, and non-audit services to the same clients. Some of the restricted non-audit services include designing of financial information systems, bookkeeping services, appraisal or valuation services, actuarial services and internal audit services (Rahman *et al.*, 2016). The corporate governance order of the SEC also demands that listed companies must rotate their audit firms in every three years (Siddique, 2012). In order to understand the problem of this study it is important to get a picture of the division between audit and non-audit services in Bangladeshi audit firms. Apart from traditional auditing, most Bangladeshi audit firms offer services to their clients that are not immediately connected to auditing. Because of the CGO 2006 by the SEC of Bangladesh, auditing firms are no longer allowed to offer their same clients both audit and non-audit services. So, the prohibition of the joint provision of audit and non-audit services must have some visible impact on competition among the audit firms in Bangladesh.

The effect of the prohibition of certain non-audit services on the competition between local auditing firms and Big-4-affiliated auditing firms in Bangladesh has not yet been investigated extensively. So, the present study aims at investigating the impact of the prohibition of certain non-audit services on the competition between local auditing firms and Big-4-affiliated auditing firms in

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Bangladesh. This study is based on personal in-depth interviews with the Big-4 auditing firms that are affiliated with local accounting firms in Bangladesh.

A qualitative approach is chosen for this paper, which is descriptive and explanatory in nature. Because of the prohibition of non-audit services, the competition on the market between them may toughen. The respondents of the Big 4 audit firms did not believe that top listed companies and or global companies in Bangladesh would appoint big consultancy firms or smaller specialized auditing firms to conduct their audit and non-audit services. However, they believe that it is possible for the big consultancy firms or smaller specialized auditing firms to enter audit market in Bangladesh. The findings of this study will be of use to financial reporting regulatory authorities in Bangladesh, such as Securities and Exchange Commission of Bangladesh as well as the Institute of Chartered Accountants of Bangladesh, regarding the corporate governance role played by the auditors in Bangladesh.

Audit regulations in Bangladesh

A number of regulatory rulings in Bangladesh require companies to have their accounts audited by a chartered accountant. A partial list of these rulings includes the Companies Act 1994, Securities and Exchange Rules 1987, Listing Regulations of the Dhaka Stock Exchange Limited 1997, etc. (Habib and Islam, 2007).

Manual of Professional Ethics- ICAB: In addition to providing legislative audit services, a lot of accounting Firms in Bangladesh provide a number of non-audit services as well. Management consultancy as well as tax advice are the two main non-audit services that are offered by the chartered accountant firms in Bangladesh. Like other countries of the world, providing non-audit services makes auditor independence worse. In 1993, the Institute of Chartered Accountants of Bangladesh (ICAB) published a manual titled “Manual of Professional Ethics” which is the only commanding published manual on professional ethics. According to this ethics manual, a professional accounting firm can provide non-audit services to their clients either by establishing an individual department inside the firm or by forming either a separate firm or an unlimited liability company (ICAB, 1993).

Prohibition of Non-audit services by SEC of Bangladesh: Through a corporate governance order, the Securities and Exchange Commission (SEC) of Bangladesh prohibited auditors from providing a few selected non-audit services such as appraisal or valuation services, financial information systems design, book keeping services, actuarial services, internal audit services, in 2006. The same corporate governance order also made it mandatory for the listed companies to rotate their auditing firms in every three years (Siddiqui, 2012).The followings are the services, which the companies should not engage their external/statutory auditors in (Rahman *et al.*, 2016):

- Appraisal or valuation services or fairness opinions: Under this point come valuing assets, liabilities and real estate. However, services for non-financial reporting are not prohibited.
- Financial information systems design and implementation: Under this point designing and implementing the information system of a client appears where the data become a part of the financial statement or where the system will produce information important for preparing the financial statement.
- Bookkeeping or other services related to the accounting records or financial statements: Under this point traditional bookkeeping and payroll services are prohibited. An auditor should not assist his client in preparing financial statement in any way because it hampers his independence. However, the auditor may advice his client on some issues like how to convert the foreign subsidiaries correctly.
- Broker-dealer services: the auditor is not allowed to advise the client whether to buy or sell client’s securities. Additionally, the audit firm is not allowed to take the investment decisions on behalf of the audit client or should not have the authority over the client’s investment.
- Actuarial services: An auditor is not allowed to provide actuarial services, like calculating the life expectancy of the employees to determine the size of pension funds, to the audit client.

- Internal audit services: The auditor is not allowed to provide most of the internal audit services, but he may recommend how to improve the client's quality of internal audit during the audit process.
- Any other service that the Audit Committee determines.

The purpose of this paper is to study the impact of the prohibition of certain non-audit services on the competition between local auditing firms and Big-4-affiliated auditing firms in Bangladesh.

METHODOLOGY

This paper is both descriptive and illustrative. To identify the impact of the separation of audit services and non-audit services, as required by CGO 2006, on the competition of Bangladeshi audit firms, we conducted in-depth personal interviews with representatives from Big-4-affiliated audit firms, one representative from each firm. Rahman Rahman Huq is affiliated with KPMG; Hoda Vasi Chowdhury is affiliated with Deloitte; S F Ahmed is affiliated with Ernst and Young and A Qussem is affiliated with PriceWaterhouseCoopers (Karim and Hasan, 2012). The interviewees are persons with sound knowledge of and regular exposure to CGO 2006. They come from firms affiliated with the Big 4 in order to visualize a holistic picture. All the interviewees are in manager level in the department of audit & assurance. The interviews were conducted in June 2015. As all the interviewees wanted to remain anonymous, their names and identities are not disclosed in this research. Most leading firms are annually audited by one of the Big-4-affiliated audit firms in which the representative works. Because of this, no representatives of any smaller auditing firms were interviewed considering that four main interviews would be sufficient for the purpose of this study.

It is important to note here that the information received from the interviews was the opinion of the persons asked, and not the opinion of their represented firms. Notes were taken and questions were asked. All the interviews were conducted in the respective offices of the interviewees. Both primary and secondary data were used. The primary data of this research consists of interviews with knowledgeable persons on the subject. Secondary data has been collected from different databases, the Internet and literature.

RESULTS

Effects on competition

Nowadays, the Big 4 auditing firms dominate not only in the audit industry in Bangladesh but also in the rest of the world. The top listed companies in Bangladesh appoint one of the Big 4 audit firms to conduct audit services (Rahman *et al.*, 2016). At the same time global companies working in Bangladesh also appoint Big 4 because of having greater knowledge regarding all parts of the audit field. All the interviewees opined that the separation of audit and non-audit services would not make the top listed and or global companies more willing to appoint Big 4 audit firms to conduct non-audit services.

The interviewees also argued that separation of audit and non-audit services will help the small firms (Specialized in one particular non-audit services) to increase their share in the audit market in Bangladesh. Some of the interviewees opined that the competition among the Big 4 audit firms would increase because of the prohibition of certain non-audit services. They argued that because of the prohibition of non-audit services, the Big 4 audit firms could not provide both audit and non-audit services to their clients. As a result the market for audit and non-audit services has become more unpredictable.

One interviewee argued that providing non-audit services is the easiest way to connect with client closely and therefore increase the opportunity to be appointed as future auditor to conduct audit services. The interviewee also opined that an audit firm could easily link up with clients and request them to use their auditing firm's non-audit services. All the respondents believe that the Corporate Governance Order 2006 by SEC of Bangladesh will increase the possibilities for companies to select audit firm other than Big 4 to conduct non-audit services. This is due to the fact that the consultants leave the Big 4 auditing firms and start their own separate business to conduct non-audit services. However, one interviewee opined that companies like Grameen Phone, Sanofi-Aventis Group, Lever Brothers (BD) Limited will never appoint audit firm other than Big 4 to conduct non-audit services as quality and reputation are very important factors for the creditability of the financial statement. A brief summary regarding the impact of the prohibition of certain non-audit services on the competition between local auditing firms and Big-4-affiliated auditing firms in Bangladesh is given below.

Audit Vs. Non-Audit Service	Effect of CGO 2006 on Competition	
	Big-4-affiliated Audit Firm	Local Auditing Firms
Audit Service	Top listed companies in Bangladesh appoint one of the Big-4-affiliated audit firms to conduct audit services.	Top listed companies in Bangladesh usually do not appoint local audit firms to conduct audit services.
	Global companies working in Bangladesh appoint Big-4-affiliated audit firms to conduct audit services.	Global companies working in Bangladesh do not appoint one local audit firms to conduct audit services.
Non-Audit Service	Big 4 audit firms could not provide both audit and non-audit services to their clients. As a result, the market share for non-audit service will decrease.	Separation of audit and non-audit services will help the local audit firms (Specialized in one particular non-audit services) to increase their share in the audit market in Bangladesh.
	Profitability does not depends on the non-audit service provided to the client.	Profitability depends on the non-audit service provided to the client.

DISCUSSION

Effect on competition

According to the Corporate Governance Order 2006 of Bangladesh, companies that are affected by the order are no longer to appoint the same auditing firm to conduct both audit and non-audit services. As a result, the competitive situation among the auditing firms is likely to change. As the provision of non-audit services are more attractive and profitable than the provision of audit services, the auditing firms in Bangladesh must find out alternative ways to attract their clients to appoint them for conducting non-audit services. This paper believes that this situation is more likely to increase the competition among the auditing firms in Bangladesh. In Bangladesh, the number of the smaller auditing firms having specialized in one particular non-audit service, increasing rapidly after prohibition of non-audit services by the SEC of Bangladesh. This situation also likes to increase the competition among the audit firms in Bangladesh. In addition to that, the competition could increase further since the new market for non-audit services could attract the big consultancy firms to increase their services to cover non-audit services. Compare with smaller specialized audit firms, these big consultancy firms will be a great threat to the Big 4 audit firms.

The respondents of the Big 4 audit firms do not believe that top listed companies/global companies in Bangladesh will appoint big consultancy firms or smaller specialized auditing firms to conduct their audits. However, they believe that it is possible for the big consultancy firms or smaller

specialized auditing firms to enter audit market in Bangladesh. Based on the discussion above, this study believes that after the separation of audit and non-audit services, the Big 4 audit firms will be able to dominate the audit market that they did before implementing the Corporate Governance 2006 by SEC of Bangladesh. This study also believes that competition will increase as big consultancy firms as well as smaller specialized auditing firms enter the audit market.

To conclude, the separation of audit and non-audit services by the Corporate Governance 2006 of SEC of Bangladesh is likely to increase the competition among audit firms in Bangladesh. Also, it can be infer that while audit market is expected to remain same, the competition for non-audit service market will increase after the separation of audit and non-audit services by the Corporate Governance 2006 of SEC of Bangladesh.

CONCLUSION

The separation of audit and non-audit services by the Corporate Governance Order 2006 of SEC of Bangladesh will increase the competition among the Big 4 auditing firms affiliated with local auditing firms in Bangladesh. This is due to the fact that provision of non-audit services is more profitable and not connected with the provision of audit services. For that reason, auditing firms must find out the alternative ways to invite clients to appoint them for conducting non-audit services. In addition, new participants will join the audit market to conduct non-audit services. These new participants comprise big consultancy firms that increase their services to cover non-audit services and the smaller auditing firms having specialized in one particular non-audit service. Because of the prohibition of non-audit services by SEC of Bangladesh, big consultancy firms from related market will be a threat to the dominance of the Big 4 auditing firms in Bangladesh.

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