INDEPENDENCE IN FACT AND IN APPEARANCE:
A STUDY OF REGULATORY DEMANDS AS MADE EVIDENT THROUGH PRACTICE

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ABSTRACT

Purpose – The purpose of this paper is to get an increased insight on a governmental regulator's view on independence in a Swedish context, with the aim to contribute to the research regarding auditor independence.

Design/methodology/approach – The research is in the form of a quantitative study examining the Swedish Supervisory Board of Public Accountant’s disciplinary rulings from the years 2004-2010.

Findings – The study concludes that the SSBPA view independence in fact as one, if not the most, important attribute for an auditor, while independence in appearance is on the other side of the spectrum, being one of the least vital.

Originality/Value – The findings of this paper show that the SSBPA’s view on auditor independence is in stark contrast to the propositions made by the European Commission and SOX, as they are more focused on mitigating issues related to independence in appearance.

Keywords – Auditor independence; Independence in Appearance; Independence in Fact; Practical Definition; Quality affecting Issues; Non-Quality affecting Issues; Regulatory Oversight; Disciplinary Rulings

Paper Type – Research paper

INTRODUCTION

In an update of the Swedish Companies Act in 1910 it was stated auditors should not be in acquaintance with the company they audit, a great alteration from former practice where the auditors were selected based on their good relationship with the companies (Sahling-Andersson & Engwall, 2002). This change was the first step in Sweden to ensure auditor independence. A few years later the risks with impaired independence became evident in the investigation of Kreuger & Toll in 1932. The commission responsible of the investigation concluded, among other things, “the Kreuger & Toll frauds could not have been concealed if either […] the audits, though not so coordinated, had been carried out in all cases with a proper honesty, efficiency and independence” (Jones, 1995, cited in Sahlin-Andersson & Engwall, 2002, pp. 257-258). As a result of this the Companies Act of 1944 was updated stressing the importance of auditor independence. Since then independence has been a recurring issue regarding the credibility of the auditor’s work.

Watts and Zimmerman define independence as “the probability that the auditor will report some discovered breaches of contract” (1983, p. 615). Audit independence is fundamentally

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about trust. However, after the Enron scandal in the beginning of the 21th century the perception of auditors’ credibility have got a turn for the worse (Francis, 2004). In addition to this the big audit firms have increased their supply of non-audit services (NAS) thus elevating the question of audit independence (Sikka, 2009). This is because research shows auditors are more prone to be affected by client pressure when the firm is also offering NAS (Felix Jr, Gramling & Maletta, 2005) and several studies provide evidence of the impairing effect NAS has on independence (e.g. McCracken, Salterio and Gibbins, 2008; Sikka, 2009; Wines, 1994).

In 2011 the European Commission released a proposition for increased auditing regulations as a response to their findings in the Green Paper Audit Policy: Lessons from the Crisis (European Commission, 2011). This proposition presents several suggestions to mitigate the risks of independence impairments also found in the American counter-part the Sarbanes-Oxley Act (SOX) e.g. audit rotation and forbidding firms to provide audit- and consulting services to the same client (ibid.) However, there has been critique against SOX that the act is only focused on mitigating risks related to the perception of independence and not factual independence issues (Tackett, Wolf & Claypool, 2004). The same concern can thus be raised towards the proposition from the European Commission.

During the last few years the auditors in Sweden have also been under increased scrutiny. For example, during the fall of 2010 the nationwide newspaper Svenska Dagbladet released a series of articles reviewing the profession. The aforementioned questionability regarding audit firms providing both audit- and consulting services was one of many aspects discussed (Svenska Dagbladet, 2010). The auditors’ ability to uphold independence is thus questioned both in academia and by the market. 

As independence is a cornerstone for credibility and reliability it is thus important for the overall quality of the audit (Antle, 1984). There are several actors who can influence and/or are affected by the quality of an audit report; shareholders, external stakeholders, clients, the auditors and (in most countries) a governmental regulator. The focus of this paper is on the latter actor. In Sweden the governmental body responsible for reviewing and monitoring the auditors is the Supervisory Board of Public Accountants (SSBPA). The SSBPA’s job is twofold; they approve auditors (a requirement to be allowed to work as an auditor in Sweden) and they supervise the auditors (Revisorsnämnden, 2012a). Like the rest of Europe, Sweden, does not offer the same self-regulating environment as e.g. the U.S., where filing lawsuits is a common mean to show discomfort towards the auditors (Carrington, 2010). Thus the SSBPA’s view becomes the main premise which the audit profession must adapt to, and their demands will mould the audit community.

With the backdrop of the concern regarding auditors’ ability to uphold independence in Europe the purpose of this paper is to get increased insight on a governmental regulator’s view on independence in a Swedish context. As actions speak louder than words the research question is how do the Swedish Supervisory Board of Public Accountants act with auditors lacking in independence?

The base of the study is 338 disciplinary rulings released by the SSBPA from the years 2004-2010. The results of the investigation will show the demand on independence in Sweden and, as argued by Carrington (2010), even though this limits the possibilities to
generalise the results it can offer valuable insight as more countries have started to change their regulatory oversight to become more similar to the Swedish model.

The next section of the paper presents a brief description of the control measures the SSBPA have at hand and the regulations regarding independence. This is followed by a literature review on previous studies about independence and a presentation of the analytical framework used in the study. The fourth section includes arguments for the choice of research design, the limitations of the paper and a description of how the study was conducted. The fifth section contains the results and the analysis leading up to the final section where conclusions, contributions and suggestions for future research are presented.

REGULATIONS ON INDEPENDENCE

At centre stage of this study is the Swedish Supervisory Board of Public Accountants (SSBPA) and their disciplinary rulings which is their primary control measure in handling independence issues in auditors. Following is a short description of these rulings and the laws, regulations and ethical codes by which they are formed according to.

Control Measures

The SSBPA have two types of control measures at hand to ensure good audit quality. They design the tests which every auditor must pass to become a qualified public accountant, thus deciding what an auditor in Sweden must know, and they can penalise an auditor not following the rules (Revisorsnämnden, 2012a).

The supervision of the auditors is carried out in different manners (Revisorsnämnden, 2012b). The SSBPA conduct quality control tests to assess the systems and processes of the audit firm to assure they are according to Swedish GAAP and GAAS (ibid.). As of the 1st of July, 2009 the SSBPA have started to release Quality control reports (ibid.) These are based on inspections carried out at every major audit firm and should at least be done every sixth year (ibid.). Furthermore, the SSBPA carry out regularly investigations, called systematic quality control (SQT), which focuses on different subjects. This includes high risk groups e.g. auditors who do not submit to the quality control of the Professional Institute for Authorised Public Accountants (FAR) and auditors with prior admonitions and warnings. Moreover, investigations are also started due to information from mass media (ibid.). Lastly, complaints regarding an auditor’s work can be filed to the SSBPA by e.g. a private person or a company. The SSBPA will then handle it as a disciplinary case and investigate whether the auditor has omitted his/her duties. If the auditor is found guilty of this the SSBPA will penalise the auditor through an admonition, a warning or removal of license (ibid.). In addition to a warning the auditor might also have to pay a fine of 25 000 SEK (approx 2840 Euro at the time of writing), however since 2005 the SSBPA have not charged an auditor with a fine (Revisorsnämnden, 2012c).
Rules and Guidelines on Independence

In Sweden there is set of regulations regarding independence. The topic is covered in 9:17 in the Companies Act (2005:551)\(^1\) and in §20 and §21 in the Auditor’s Act (2001:883)\(^2\), which is in accordance to Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. There are also recommendations in the Statutory Auditor’s Independence in the EU: A Set of Fundamental Principles and guidelines from FAR (the professional institute of public accountants in Sweden).

In §19 of The Auditor’s Act (2001:883) it is stated the auditor should uphold sound audit practice (in Swedish: God revisorssed). Sound audit practice means the auditor should act in accordance to professional ethics based on recommendations from FAR (Regeringens proposition 2000/01:146). These recommendations are found in EthicsR 1 Code of Professional Ethics (translated from: EtikR 1 Yrketisk regler) (FAR, 2011). They in turn are based on rules set by the International Federation of Accountants (IFAC) which FAR, as a member of the organisation, must oblige to (FAR, 2012a).

To ensure independence FAR has created a principle-based framework (FAR, 2011) and a flow-chart on how to use it (see Appendix C). The purpose of the framework is to help the auditor identify threats, evaluate the significance of these and eliminate or mitigate them. According to FAR independence is made up of independence in fact (IIF) and independence in appearance (IIA) (ibid.). The former encompasses the state of mind which makes it possible for auditor to do a true-and-fair assessment. IIA is about avoiding being in a scenario which would make a well-informed third party draw the conclusion the auditor’s independence has been impaired. The document contains a thorough list of examples which could impair independence and suggestions on how to mitigate the risks of them. A few examples are; temporary lending personnel, a senior person’s working for a long time with a client, providing additional services, providing valuating services, tax consultancy, internal audit services, IT-services, recruitment services, legal services and corporate finance consulting (FAR, 2011).

INDEPENDENCE

Independence is an abstract concept and it is difficult to define either generally or in its peculiar application to the certified public accountant. Essentially it is a state of mind. It is partly synonymous with honesty, integrity, courage, character. It means, in simplest terms, that the certified public accountant will tell the truth as he sees it, and will permit no influence, financial or sentimental, to turn him from that course (Carey, 1946 cited in Scheutze, 1994, p. 69)

The quote above by a former senior staff officer of the American Institute of CPAs (AICPA) clearly describes how the concept of independence is applicable to an auditor. Of course, independence is not the only quality needed in auditing – accounting competence and auditing techniques need to be in place. However, with a lack in honesty, integrity, courage and character the auditor’s report risks not fully expressing his/her actual opinion to the stakeholders. Seeing as the auditor is a major mean for assuring a high quality in the

\(^1\) See Appendix A for transcript of 9:17 in The Companies Act
\(^2\) See Appendix B for transcripts of §20 and §21 in The Auditor’s Act
financial reports which the stakeholders rely upon auditor independence thus becomes a keystone in today’s capital markets.

In addition to explaining why independency is an essential ingredient in performing audits there is another aspect captured by the quote above; independence is an individual mindset in the auditors and hence difficult to test or regulate in a timely manner (Scheutze, 1994). As this state of mind is unobservable to the outside a distinction is usually made between two dimensions of independence. On the one hand there is independence in fact (IIF), which indicates the “[…] auditor possesses an independent mindset when planning and executing an audit, and that the resulting audit report is unbiased” (Dopuch, King and Schwartz, 2003, p. 84). This is regulated in §20 of the Swedish Auditor’s Act, saying this is a requirement for auditors to comply to. This type of independence breach can be seen as being the truly important issue in auditing and with perfect information this would be the only type of independence to be concerned about. However, as IIF is an individual mindset the term independence in appearance (IIA) often come to use. This type of independence is obtained just by the auditor appearing to be independent. This is explicitly defined in §21 of the Swedish Auditor’s Act. IIA is, contrary to IIF, visible to the outside and can practically be used as a proxy for detecting IIF. However, appearing to lack independence does not necessarily equal to lacking independence in fact.

As aforementioned, IIF is essentially the important type of independence in regards of audit quality as it makes it possible for the auditors to provide reliability in the financial reports. Based on this idea Tackett et al. (2004) argue that regulators should focus on IIF as actions taken against IIA will not mitigate the risk of audit failures. However, if stakeholders perceive the auditor to lack independence, regardless of this actually is the case, this comfort will be lost and it will not matter whether or not the financial reports can be relied on (Hodge, 2003). This makes IIA an important issue per se for regulators to consider and not just a practical proxy for detecting IIF. Hence, if Turner’s (2000) opinion that independence is all about investors’ confidence in the numbers and markets IIA is perhaps an even more important issue than IIF. A third view is held by Carey who states “to be suspected is almost as bad as being convicted” (1946, as cited by Scheutze, 1994, p. 70) implying that IIF is what is utterly important but that IIA cannot be disregarded due to its effects on the markets confidence. Ultimately it comes down to how the value of an audit is defined as; if it is about only about discovering issues and offer high quality in the report then IIF is what matters. However, if it is also about offering comfort for the stakeholders then IIA is equally important.

Impairment in IIF

According to Johnstone, Sutton and Warfield (2001) there are two pre-conditions for a risk of an independency breach; first, there must be an incentive for the auditor not to report truthfully and secondly; a judgement-based situation must occur. This type of situation arise due to (1) difficult accounting issues e.g. fair-value estimations, (2) audit conduct i.e. to which extent does the auditor go to search for evidence and (3) materiality decisions (Johnstone et al., 2001). They (ibid.) say the incentive can be direct, i.e. regarding financial aspects, and indirect, which are other circumstances with the potential of impairing the auditor’s objectivity e.g. a close relationship with the client.
The financial factor is an important issue regarding independence and it is perhaps the first argument which comes into mind when debating the subject. From a theoretical viewpoint research shows auditors do have a financial incentive to act biased. Using Game theory Antle (1984) investigates auditor independence. In the analysis he (ibid.) uses three players; the owner of a firm, the manager and the auditor. The two former are in a principal-agent relationship and everybody are self-interested and wishes to maximise their utility. The owner is in this theoretical perspective better off with an independent auditor than one who is not independent (ibid.). From a sound and practical viewpoint this is of course difficult to argue against. Regarding the auditor Antle (1984) says without any forces to prompt for independence the auditor is at least as affluent forsaking it than he/she is maintaining it. This stems from the owner’s inability to monitor the transactions and dealings between the manager and the auditor (ibid.). As with most theories it has some obvious limitations due to its speculative nature and presumptions. Nevertheless, it does help setting the stage showing how e.g. NAS and low audit fees might impair IIF, a much disputed statement.

Identifying a Breach

As the audit firms have started to offer more NAS concern has been raised this will impair independence, a well-founded concern according to several studies. In a study of companies in Australia Wines (1994) provides evidence companies with higher non-audit remunerations fees in general receive unqualified reports. Wines (1994) argues this could be seen as an indication of NAS having possible negative effects on independence. Moreover, a recent study regarding the subject by Felix Jr et al. (2005) shows a direct link between the amount of NAS provided and the extent to which the auditor was affected by client pressure. Furthermore, through a study McCracken et al. (2008) discovered both auditors and CFOs tend to perceive the auditor’s overall role is to perpetuate a good relationship. Moreover, they (ibid) say the CFO has several ways to “control” the auditor. These studies support the idea NAS has a negative effect on independence. As a client begin to buy NAS the financial value of the client for the audit firm increases. Thus, the incentive to keep the client satisfied increases as well. Not including any other aspects e.g. the auditor’s sense of ethics and the risks of being penalised the auditor has no reason to act independently (unless the client would prefer it). Of course, the real world is not as black and white; the auditor does have other aspects beyond pure financial factors to take into consideration. Nonetheless, the financial incentive is in favour of biased auditing and research also shows practical evidence of this.

Not everybody agree NAS impairs independence though. DeFond, Raghunandan and Subramanyam (2002) argue for the lack of correlation between NAS and reduced independence. Moreover, the difficulties of determining whether or not NAS have an impact on independence are highlighted by Ashbaugh, LaFond and Mayhew (2003). Using the same data as another group of researchers (Frankel, Johnson and Nelson in 2002) they arrived to an opposite conclusion to their peers; they could not find any relationship between increased fees and reduced independence (Ashbaugh et al., 2003).

As made evident by Ashbaugh et al.’s (2003) “counter-research”, it is difficult to search for correlations when doing a quantitative study of independence. Through changing a few
variables empirical data could show two opposite viewpoint. The possibilities of mixing with variables to reach different conclusion is nothing new of course and is one of the inherent weaknesses of the quantitative research method. However, the other issue with this type of studies is the difficulties of actually identifying when independence is impaired. The researchers use a variety of proxies as signs of reduced independence. These proxies ranged from levels of discretionary accruals, the financial statements proximity to earnings benchmarks/forecasts to simply interpreting that a non-qualified report indicates an independence risk. The problem is due to the lack of insight in the auditor’s work it is in most cases impossible to know whether independence is impaired or not. The group of people with the best possibilities to identify an independence breach is the auditor and the manager but neither of them has any reasons to report it. Thus, as aforementioned, to make a quantitative study using financial information assumptions have to be made which reduces the credibility of the research. This, of course, does not make studies such as Wines’s (1994) and Ashbaugh et al’s (2003) pointless but it is important to be aware of the difficulties of actually identifying independence breaches through their research method. Lastly, and most importantly, regardless of the mixed findings in academia regarding the correlation between NAS and independence impairments, the general consensus is that NAS have an impairing effect on audit quality (Francis, 2004) and in the end the perception is all that matters (Hodge, 2003).

The Incentives to Be Biased

As touched upon, the audit fee might also have a negative impact on independence. Bazerman, Morgan and Loewenstein (1997) argue low balling, where the auditor offers his/her services for an unprofitable fee to attract the client, reduces independence. This is because once a new client is signed the auditor need to keep the customer for a few years to make a profit from the business (ibid.). This concern has been shared by the Securities and Exchange Commission (SEC) in the U.S (DeAngelo, 1981). However, according to DeAngelo (1984) low balling does not affect independence. She (ibid.) believes it is simply a reaction to a competitive market. DeAngelo (1984) argues the transaction costs of changing auditor are fairly high and therefore companies would be reluctant to do it simply because they are not pleased with their auditor. A somewhat peculiar situation thus occur; the auditor should keep the client pleased, which would impair the independence, to not risk being fired “prematurely” and the client has no incentive to switch auditor regardless of opinion because the replacement cost is too high. Since both parties share the same goal; maintain the relationship, they have reason to cooperate. This motive for collaboration leads back to Antle’s (1984) hypothesising with Game theory in which he comes to the conclusion that NAS and low balling have a negative effect on independence. In his theory (ibid.) the auditor is in two games, one with the owner and one with the management. The inclusion of NAS and low ball-charging increase the auditor’s utility for playing along with the manager while the utility for satisfying the owner remains the same. Thus, these additions increase the auditor’s incentive to collaborate with the management which would diminish independence. The importance of the interaction between auditor and manager is evident both from theory and practice making the findings by Felix Jr et al. (2005) and McCracken et al. (2008) regarding client- relation and pressure of essential value.
An important assumption Antle (1984) makes is the choice to forsake independence is a conscious decision made by the auditor. Whether this holds true independence could also be breached due to unconscious decisions. Johnstone et al. (2001) call these indirect incentives, where the auditor acts biased because of the auditor-client relationship.

Moore, Loewenstein, Tanlu and Bazerman (2003) argue auditors might act biased unconsciously. They (ibid.) present the concept of egocentric or self-serving bias: when one way of interpreting information is beneficial for oneself people tend to see this as a fair assessment. As argued above, auditors have incentive to please their clients which they are able to do if they present an unqualified audit report. Thus, signing their client’s financial statements as according to standards is beneficial for the auditors and this, Moore et al. (2003) argue, could be reflected in their work. The results from their (ibid.) research indicate auditors tend to adapt their judgements to better suited to the firm/person they are held accountable to and that people has a propensity to underestimate their own level of bias. Bazerman et al. (1997) claim it is impossible for auditors to be impartial due to the relationship with their clients. In line with Moore et al.’s (2003) thoughts, Bazerman et al. (1997) discuss psychological research and the self-serving bias. Experiments have shown judges, doctors and policemen all are affected by this (ibid.) so why would not auditors?

Furthermore, as emphasised by Bazerman et al. (1997), the auditor most likely feels a greater connection to the client than to the faceless group of shareholders. Even though the auditor, in theory, should have the public interest in mind it does not change the fact that the auditor is working for the client. It is they, not the public, who pays for the auditor’s services. As Bazerman et al. (1997) put it; a misinterpreted report will only hurt “statistical”, anonymous people while qualified report will harm a client who the auditor has worked closely with and who he/she relates to on a more personal level. As the auditor spends years working with the same client a bond and sense of connection is created which, unconsciously or not, should have a negative effect on the auditor’s independence. The idea behind this indirect incentive is appealing and research supports it (e.g. Bazerman et al., 1997; Moore et al., 2003). Due to the increase of judgement-based decision in auditing the issue becomes of an even greater concern and it stresses the importance of regulations and clear guidelines.

**Impairment in IIA**

In the end, whether auditors act independently or not, if the public do not trust the auditors their report loses its purpose. In a survey sent to 414 nonprofessional American investors Hodge (2003) asked straight-forward whether they believe auditor independence has declined during the last five years. The results showed the investors did believe auditors have become more biased. His (ibid.) research is thus a good piece of evidence of the importance for regulators to increase the independence of auditors, or at least the perception of it. Since the research was done in the U.S it cannot support the idea that Swedish investors feel the same on only its own merits. However, even though it is not possible to directly apply Hodge’s (2003) findings to the Swedish market it shows audit scandals have a negative effect of the perception of independence. Moreover, there are reasons why Swedish investors should share the belief of their American peers. Hodge’s (2003) study was done in the wake of the Enron scandal and it is a foregone conclusion this event affected the result. With the
forced liquidation of HQ Bank the Swedish market is in a similar situation as the scenario back when Hodge did his study in 2003.

Without credibility, the audit business adds cost for all parties. Johnstone et al. (2001) say a lack, real or perceived, of independence is in the long run harmful for every stakeholder. Investors and creditors suffer from it due to the risks of false financial reports and in the long-run the clients are harmed as well as investors demand a premium for the uncertainty of the financial reports. As the credibility of the audit report decreases the usefulness of the auditor and the audit profession diminishes (ibid.). An argument supported by a study by Krishnamurthy, Zhou and Zhou (2006). They (ibid.) studied the stock prices of Arthur Andersen’s clients at the time of the Enron scandal. Their (ibid.) result showed the stock prices of the companies went down at the time of the scandal and the corporations with a lower level of independence (defined by using a proxy) suffered the most. The study shows the impact a lack of trust in auditors can have on the market.

According to Johnstone et al. (2001) there are several factors which could reduce independency-related issues. This includes corporate governance, regulatory oversight, firm policies, firm culture and individual characteristics. As research has shown the audit firms do not have the incentives to deal with the issues nor do the public trust in their agenda. The regulatory oversight, in Sweden the SSBPA, thus become the most suitable (and perhaps only) player to ensure independence. Johnstone et al. (2001) suggest regulators, to mitigate the independence risk, should put their focus on; judgement-based decision situations, increased public disclosure of their findings (e.g. problems and outcomes) and peer-reviews.

The Regulator’s Role

Studies have shown when it comes to the matter of ensuring independence auditors are more responsive to punishment than reward. According to DeFond et al. (2002) the threat of lawsuits and loss of reputation are two functional reasons for the auditor to remain independent. Moreover, a study by Ponemon and Gabhart’s (1993) where they interviewed partners and management shows independence-related judgement calls are most influenced by the risk of penalties and punishment. They (ibid.) argue that, in general, the decision on how to act on independence-related issues is based on the auditor’s perception of the punishment resulting from disobeying. Furthermore, McCracken et al. (2008) also stress the importance of regulators to ensure auditor independence. They (ibid.) say without the risks of punishment and “getting caught” there are simply too many incentives to act biased without any cons to counter the pros. As the governmental supervisor the SSBPA thus play a pivotal role to ensure auditor independence.

Dillard and Yuthas (2002) have created a framework for ethical research which shows the regulator’s role in the audit community and the affects of different penalty levels. The framework is based on Structuration theory, Responsibility ethics and Stakeholder theory. Developed by the sociologist Anthony Giddens Structuration theory is a tool to view "the integrating dynamics that make up, and take place within, an ongoing community" (Dillard & Yuthas, 2002, p. 53). Social integration in a community is evolved through action and interaction between agents and these choices are in turn providing the environmental basis for future actions (ibid.). The basic premise of Responsibility ethics is “individual actions are the result of the actor’s interpretation of past actions and anticipated responses to proposed
actions within the context of an ongoing community” (Dillard & Yuthas, 2002, p. 52). To successfully use Responsibility ethics Dillard and Yuthas (2002) suggest the use of Stakeholder theory. The auditor’s role in this context is to offer assurance regarding the truthfulness of a company’s financial report to the stakeholders and thus reduce the level of uncertainty and the cost this carries (Wallace, 1991). The auditor is hence an intermediate between stakeholders and the company to reduce uncertainty. However, as research shows, the uncertainty today lies with the audit report itself.

Stakeholder theory can be applied with the audit report as the focus point to map the audit community which Dillard and Yuthas (2002) discuss. In this context the auditor-client replaces the corporation and the regulator becomes the intermediate between the former and the stakeholders. Identical to the auditor’s original role the regulator’s purpose is here to ensure the stakeholders that the audit report is trustworthy. To secure credibility the regulator can threaten to penalise the auditor if he/she is misbehaving. Hatherly, Nadeau and Thomas (1996) have examined the affect different penalty levels have on audit quality through the use of Game theory. As with Antle’s (1984) experiment, the game is played by two participants; the auditor and the client. In their study, Hatherly et al. (1996) test the affect a third party actor (the regulator) with the power to penalise has on the game. Their (ibid.) work shows punishments could have a positive effect on audit quality but only at the right penalty level. If it is too low or too high the auditor is indifferent to it when making decisions. As shown by Carrington (2010) the SSBPA tend to choose light punishments; warnings and admonitions, when penalising auditors thus making the affects with a too high penalty level irrelevant in a Swedish context.

Using Hatherly et al.’s (1996) findings in Dillard and Yuthas’s (2002) framework shows some possible negative implications a low penalty level can have on the audit community: When facing an ethical dilemma the interaction between the stakeholders must first be taken into consideration. The client-auditor relationship has already been covered and shows a situation where cooperation between client and auditor is beneficial for both parties. Next, when faced the ethical dilemma the auditor will look into the past; how have auditors previously dealt with similar situations? This is followed by the accountability-stage, where the auditor assesses the consequences of the different options. Due to the undisclosed nature of the audit process the auditor will be held accountable to (1) his/her client, whom, as aforementioned, he/she has incentive to cooperate with, and (2) the regulator. Then, if the penalty level is too low the regulator’s influence on the auditor’s choice is limited and in the final stage, Response, the auditor is therefore encouraged to make the unethical choice. Moreover, according to Structuration theory, this interaction between the actors will have further implications as well as it provides the environmental basis for future action. The unethical action of the auditor will be the basis for his/her predecessor’s choice when facing the same situation and thus creating a negative cycle of unethical behaviour and making the regulator’s work is in vain. Despite the limitations of this assumptive theoretical discussion it offers insight useful for the research: It shows the impact the regulator have on the on the audit field and how their actions mould and shape the audit community.
ANALYTICAL FRAMEWORK

As theory shows, independence is in its current definition a subjective concept where a distinction is made between independence in fact (IIF) and independence in appearance (IIA), where a breach in the former equals to actual independence impairment and the latter merely indicates there is a risk of it. Previous research show a focus from regulators to uphold both of these dimensions of independence in auditing is needed (e.g. Ponemon & Gabhart, 1993; McCracken et al., 2008; Johnstone et al., 2001). Breaches in IIF risk leading to misleading financial statements, which have obvious negative consequences, and breaches in IIA risk leading to a declining trust and credibility in the financial markets which will decrease the market efficiency (Tackett et al., 2004). Clearly these dimensions of independence have its merits as its importance touches upon different areas. One concerns audit quality and failures and the other is about legitimacy, confidence and comfort in the audit profession and financial markets. As they have these differences they should arguably be treated differently in relation to the importance of respective area of concern in which the dimension of independence it relates to.

According to Tackett et al. (2004) there are four types of root causes to audit failures:

1. Auditor blunders caused by unintentional human error
2. Auditor fraud
3. Undue influence caused by financial interests
4. Undue influence caused by personal auditor-client relationships.

This shows that audit failures can happen even if the auditor is completely independent, due to the human factor. However, there is a greater risk of occurrence when the auditor is lacking in independence due to the risk of fraud or undue influence.

Table 1. Auditor’s independence and its affect on audit quality

<table>
<thead>
<tr>
<th>Auditor is:</th>
<th>Fraud/Biased judgements</th>
<th>Human error</th>
<th>Audit report without errors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent</td>
<td>No risk</td>
<td>Risk of audit failure</td>
<td>No effect</td>
</tr>
<tr>
<td>Lacking in IIF</td>
<td>Audit failure</td>
<td>Risk of audit failure</td>
<td>No effect</td>
</tr>
<tr>
<td>Lacking in IIA</td>
<td>No risk</td>
<td>Risk of audit failure</td>
<td>Loss of credibility</td>
</tr>
<tr>
<td>Lacking in both</td>
<td>Audit failure</td>
<td>Risk of audit failure</td>
<td>Loss of credibility</td>
</tr>
</tbody>
</table>

As illustrated by Table 1, regardless of independence level there is always a risk of audit failure due to ordinary mistakes i.e. human errors (relating to e.g. auditor fatigue). Removing this factor from the equation shows the risks relating to the different dimensions of independence. An auditor lacking in IIF could cause an audit failure through conducting fraud or making biased judgements. However, the auditor could as well present a correct audit report which thus would have no affect on the overall audit quality as the factual independence breach does not change the fact the numbers presented are sound. On the contrary, an auditor lacking only in IIA will not conduct fraud or be under undue influence however even though he/she presents a sufficient audit report it will still lead to a loss of credibility which reduces the value of the audit report and hurts the legitimacy of the profession. Lastly, the auditor could also be lacking in both IIF and IIA (which would be equal to a biased auditor getting caught) which would lead to a risk of audit failure due to fraud/biased judgements and a loss of trust.
Independence issues: Quality affecting and Non-Quality affecting

Previous research and theory have shown the two dimensions of independence, IIF and IIA, though theoretical useful have some practical problems. Therefore, there is a need for an analytical framework to analyse the SSBPA’s disciplinary rulings.

In practice, there is no way to differentiate against these dimensions of independence as IIF is an invisible state of mind. And even if this was possible, a breach in IIF does not necessarily imply a reduced audit quality – just because an auditor is prepared to act biased, it is not sure that this has (or ever will) happen. Thus, audit quality could be high even if the auditor is breaching in IIF.

Hence, there is a need to distinguish between the two types in a different and more concrete way to be able to investigate how regulator's view independence.

If an auditor has been sentenced to a breach in independence but no other error has been made of the kind which will affect the quality of the financial report this independence breach cannot be claimed to be hurtful to anything but the stakeholders’ confidence in the audit, hence this is named a Non-Quality affecting issue (Non-QA). The other type is titled a Quality affecting issue (QA) which occurs when the sentenced independence breach is combined with one or numerous errors which is directly related to the quality of the audited financial report. Of course, there is a possibility these errors are non-related but for practical reasons there is a need to draw the conclusion that there is a greater chance for the relation than for it merely being a coincidence. By following this classification there is a practical way to differentiate between independence breaches which are hurtful to different areas: QA primarily damage the audit quality (i.e. IIF) where as Non-QA only reduces market confidence (i.e. IIA). The difference between the two types of distinctions is while IIA could indicate a breach in IIF this does not hold true for Non-QA and QA as otherwise the regulator would have picked up on this when investigating the auditor and thus making the issue a QA. There is of course a risk the regulator fails to notice that another error has occurred when investigating however, again for practical reason, it is assumed the regulators would have picked up on the other wrong-doings if there were any.

QA and Non-QA will be used in the analysis to differentiate between reported independence breaches according to Table 2.

Table 2. Differentiation between Quality affecting and Non-Quality affecting issues

<table>
<thead>
<tr>
<th>Independence issue</th>
<th>Quality issue</th>
<th>Non-quality issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-QA (IIA)</td>
<td>QA (IIF)</td>
<td>Non-QA (IIA)</td>
</tr>
<tr>
<td>QA (IIF)</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Non-QA (IIA)</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

The type of wrong-doings categorized as Quality issues and Non-quality issues will be elaborated in the following section. The principle, however, is that “quality” relates to the information in the financial reports and the information reaching the various stakeholders.

1 The use of quality is not referring to the broad topic Audit Quality (which encompasses independence). Instead quality in this context is about the condition of the auditor's work i.e. working according to Swedish GAAS.
Conversely, as the study concerns independence, wrong-doings which only relates to adversely affecting the client will not be regarded as a quality issue in this perspective.

**RESEARCH DESIGN AND METHOD**

The focus of this study is the SSBPA’s view on independence i.e. what they demand of the auditors in regard of this subject. To investigate this a quantitative approach using secondary data was selected over a qualitative method. The reason behind this is due to the importance of visibility in the matter. As shown above, it is the perception of independence which ultimately matters and therefore the data available for the public is the most important source of information. A more qualitative approach with interviews could have been selected to get increased insight of what goes on behind the scene at the SSBPA but ultimately it is not what they say but how they act which matters. It is the demand put by the SSBPA, in the form of disciplinary rulings, which is carried over to the auditors. Thus, to identify the SSBPA's view on independence it is the tangible and visible opinion which matters. However, in regards of auditor independence the results and the visible indications are arguably more important than the process. Therefore, in accordance with Ghauri and Grondal (2005) view, a study focusing on results and an “outsider view” a quantitative study is preferable. However, this limits the depth of the study. In a disciplinary case consisting of several wrong-doings it is not possible to assess the proportional weight of one wrong-doing and relative effect on the punishment. Furthermore, the number of wrong-doings in a ruling is partly affected by who instigated it. A disciplinary case resulting from a systematic quality control (SQT) by the SSBPA contains in general more wrong-doings (often several examples of the same type of error) than e.g. a report filed by the Swedish Tax Agency (STA) or a private person. This limits the conclusions possible to make in regard of the correlation between number of wrong-doings and punishment. Moreover, it is not in all cases possible to identify which wrong-doing which was the main cause of the disciplinary case, further limiting the amount of conclusions possible to make.

**The Empirical Data**

The empirical data consists of disciplinary rulings which have gained legal force in the years 2004 to 2010. Originally the empirical material included the examination tests to become approved and authorised public accountant (which was scrapped as it did not offer anything for the study) and the choice to use the year 2004 as the beginning of the period was based on the number of exams available. At the time of writing there were a significant smaller amount of disciplinary rulings which have gained legal force in 2011 and therefore the year of 2010 was selected as the end of the period. Due to this the most recent empirical material available is excluded which somewhat reduces the topicality of the data. However, if the disciplinary cases of 2011 had been included they would only have made up of 6% of the total data and therefore the decision was made to prioritise yearly consistency over maximum topicality. 345 disciplinary ruling for the time period is published on the SSBPA’s website (Revisorsnämnden, 2012d) but seven of them had been written off and is therefore excluded from the research. All in all, the empirical data consists of 338 disciplinary cases.
Pilot Study

To improve the process of reviewing the disciplinary rulings a pilot study was conducted for the coding process. The pilot study made it possible to get insight of the structure of the disciplinary cases and by performing the coding process before the actual study the overall quality of the empirical research increased. Moreover, the use of the pilot study to settle all details of how to design and structure the empirical research made it possible to avoid otherwise inevitable backtracks when reading the rulings.

The pilot study consisted of 10% of all disciplinary rulings, 35 in total. To mirror the actual study these 35 were taken evenly from the seven years i.e. five cases per year. The selection of cases on the yearly basis was done through dividing the total amount of cases with five and then picking the cases from that numerical pattern. For example, in 2004 there were 45 cases and since 45/5 = 9, every ninth was selected thus removing any possible seasonal affects. Ghauri and Gronhaug (2005) suggest to improve the reliability of the coding the researchers should do it independently. Accordingly the categorisation of the pilot study was first done individually and afterwards the findings were compared to settle on the categories and information which would be used for the actual study. When starting the classification from scratch the first few cases could potentially have more impact on the coding process than the rulings read last. To reduce this risk and increase reliability the cases were therefore read in opposite chronological order, starting with the first and last respectively. Moreover, at this stage there were some uncertainty regarding the information available and what would be useful for the study. Therefore, the coding process covered the following span of topics and categories; Year, Penalty level, No. of former punishments, Auditor level, Size of firm, Size of client, Instigator, No. of wrong-doings, Type of wrong-doing.

Reading the Disciplinary Cases

The disciplinary cases vary in length, ranging from 1-2 pages up to 36 pages depending on the number of wrong-doings the auditor is accused of and the instigator (cases based on a SQT or filed by FAR are often more thorough). The first section of a ruling generally presents information of who has filed the report, whether the auditor is approved or authorised and some background information pertaining the case. However, information regarding instigator and auditor level is not always included. This section is followed by remarks from the auditor regarding the wrong-doing if he/she has opted to do it. The disciplinary case is then concluded by an assessment from the SSBPA where they argue what the auditor has done wrong and what the punishment will be. If the report consists of several wrong-doings they are first presented individually with background information and assessment from the SSBPA and the final section of the report then consists of a summary of all of the auditor’s wrong-doings and presents the selected punishment. The concluding part of the case also includes prior punishment the auditor has received if there are any.

Based on the literature review, the pilot study and feedback from our supervisor, Thomas Carrington, the following information was collected from the disciplinary cases; No. of disciplinary cases (usually 1), Year, Instigator, Previous rulings, Auditor level (approved or authorised), No. of assessments and Punishment. The wrong-doings were put into one of three categories relating back to the analytical framework; Independence issue, Quality issue
or Non-quality issue. Independence issue demands no further explanation. The category Quality issue consists as the name suggest of wrong-doings related to the quality of the auditor’s work e.g. using a proper materiality level when auditing a client or presenting a truthful audit report. As aforementioned in the Analytical framework, quality is here in regards of the auditor's work for a third party. A quality issue is thus in this categorisation a problem/concern which reduced the value of the audit for an external stakeholder. Non-quality issue contains wrong-doings not related to either independence or the quality of the audit i.e. wrong-doings which only hurt the client, "technical" issues and internal wrong-doings in regards of e.g. running a firm.

To make the data manageable the wrong-doings were classified into one of six types:

**Conflict of interest**
In these cases the auditor is proven guilty of not following 9:17 in the Companies Act i.e. situations when the auditor is not allowed to work due to a conflict of interest. An example is in Dnr 2004-349 where the auditor audited a company even though he was aware of that the audit firm also helped the company with the management of their bank account.

**Independence impairment**
The second type consists of cases where the auditor is reported for not following §20 and §21 of the Auditor’s Act. In Dnr 2006-1401 the auditor audited two accounting offices and 24 of their customers. According to the SSBPA this could cause concern regarding the auditor’s independence and therefore she should have resigned.

**Poor judgement**
This is the broadest type of wrong-doings and it is situations where the auditor’s decision on how to conduct the audit is the issue. In Dnr 2007-925 the auditor was penalised because he had not reviewed the routines regarding handling the bursary and cash even though these are two typical high-risk areas in the client’s line of business according to the SSBPA. In another case, Dnr 2010-95, the auditor based his opinion regarding future payments solely on the management’s word while according to the SSBPA a thorough review would have been in order.

**Insufficient documentation**
Another type of wrong-doing is when the auditor is charged for not following §24 of the Auditor’s Act regarding documentation. An example of this self-explanatory type is Dnr 2007-1091 in which the auditor had not sufficiently documented his review process regarding the valuation of goodwill. As stated in all cases where this issue is discovered the SSBPA deem this type of wrong-doing severe since it impairs their possibility of assessing the auditor.

**Non-disclosure**
This category consists of situations where the auditor discovers or is aware of an issue but choose not to comment on it in the audit report. In Dnr 2006-656 a client acquired a large amount of shares in another company without accounting for this in the balance sheet. The auditor was aware of this but did not make any remarks in the audit report and thus he omitted his responsibilities as an auditor according to the SSBPA.

**Other**
All wrong-doings unrelated to independence or the quality of the auditor’s work were put in one single category to reduce unnecessary noise. This type includes a variety of cases. Some examples: Dnr 2004-1433 is about an audit verification which was not up to code, another is Dnr 2010-835 in which an audit firm was penalised for owning real estate. Lastly, in Dnr 2010-170 the auditor had not informed the board of director the annual report was submitted seven months after the deadline.

Table 3. Type of wrong-doings

<table>
<thead>
<tr>
<th>Independence issue</th>
<th>Quality Issue</th>
<th>Non-Quality Issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conflict of interest</td>
<td>Poor judgement</td>
<td>Other</td>
</tr>
<tr>
<td>Independence impairment</td>
<td>Insufficient documentation</td>
<td></td>
</tr>
<tr>
<td>Non-disclosure</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

As shown, three of the types were identified as when the SSBPA based their decisions on the Auditor’s Act and/or the Companies Act and thus increasing the reliability and removing the issue of subjective judgment. Moreover, Non-disclosure and Other had little room for different interpretations. The weakest link in regards of the risk of subjective influence was Poor judgement. However, the potential issues related to this type should logically be off-set by the lack of subjective assessment needed for the other five types.

When reading the cases the process from the pilot study was repeated i.e. the cases were first read individually, starting in chronological opposite ends and then the findings was compared and differences discussed.

RESULTS AND DISCUSSION

Wrong-doings and Punishments

The most common way the SSBPA choose to punish an auditor is through a warning; more than 50% of the disciplinary cases ends with this type of punishment (see Table 4). This is followed by the lightest penalty, admonition which the SSBPA deem to be the appropriate sanction in 1/3 of the times. Removing the license is a punishment sparsely used; in 41 out of 338 cases (12.13%) the auditor lost the license due to his/her misbehaviour. The wrong-doing Poor judgement is the most prominent, being a part of 60% of the cases while Conflict of interest and Independence impairment are the most and second to most infrequent wrong-doings. Even when aggregated Independence issue is the least represented with quite a margin; after Independence issue Insufficient documentation is the most infrequent, the former is found in 80 (23.67%) while the latter is in 108 (31.95%) of all cases. This can be interpreted as the SSBPA do not bother much about independence issues or that they are difficult to identify.
Table 4. Wrong-doing and punishment

<table>
<thead>
<tr>
<th>Wrong-doing</th>
<th>Admonition</th>
<th>Warning</th>
<th>Removal</th>
<th>All Cases²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conflict of interest</td>
<td>3 (8.57%)</td>
<td>22 (62.86%)</td>
<td>10 (28.57%)</td>
<td>35 (10.36%)</td>
</tr>
<tr>
<td>Independence impairment</td>
<td>9 (16.07%)</td>
<td>36 (64.29%)</td>
<td>11 (19.64%)</td>
<td>56 (16.57%)</td>
</tr>
<tr>
<td>Independence issue</td>
<td>11 (13.75%)</td>
<td>51 (63.75%)</td>
<td>18 (22.5%)</td>
<td>80 (23.67%)</td>
</tr>
<tr>
<td>Poor judgement</td>
<td>42 (20.59%)</td>
<td>126 (61.76%)</td>
<td>36 (17.65%)</td>
<td>204 (60.36%)</td>
</tr>
<tr>
<td>Insufficient documentation</td>
<td>7 (6.48%)</td>
<td>67 (62.04%)</td>
<td>34 (31.48%)</td>
<td>108 (31.95%)</td>
</tr>
<tr>
<td>Non-disclosure</td>
<td>38 (29.01%)</td>
<td>76 (58.02%)</td>
<td>17 (12.98%)</td>
<td>131 (38.76%)</td>
</tr>
<tr>
<td>Quality issue</td>
<td>72 (27.07%)</td>
<td>157 (59.02%)</td>
<td>37 (13.91%)</td>
<td>266 (78.7%)</td>
</tr>
<tr>
<td>Non-Quality issue</td>
<td>40 (32%)</td>
<td>68 (54.4%)</td>
<td>17 (13.6%)</td>
<td>125 (36.98%)</td>
</tr>
<tr>
<td>All Cases</td>
<td>109 (32.25%)</td>
<td>188 (55.62%)</td>
<td>41 (12.13%)</td>
<td>338 (100%)</td>
</tr>
</tbody>
</table>

While being at the bottom regarding frequency Insufficient documentation and Independence issues lead to the harshest penalties. 31.48% of all cases when the auditor is punished for Insufficient documentation he/she loses the license. For Independence issues the same statistic is 22.5%. Moreover, when any of these wrong-doings is discovered the SSBPA rarely settle for an admonition. Only 7 of 108 (6.48%) cases with Insufficient documentation and 11 of 80 cases (13.75%) for Independence issues conclude with the lightest form of punishment. The data also shows Conflict of interest is seen as a more critical issue than Independence impairment; 28.57% of all Conflict of interest lead to a removal of license and in only 8.57% the SSBPA settle for an admonition while for Independence impairment the numbers are 19.64% and 16.07%. On the opposite side of the spectra are Non-disclosure and Other wrong-doings. The SSBPA generally take lightly on these issues, a small percentage (12.98% and 13.60%) lead to a removal while 29.01% and 32% of the cases the punishment is an admonition. Throughout all wrong-doings the percentage of warnings is rather consistent with the total average and the difference is instead found between admonitions and removals. The type of wrong-doing the auditor is penalised for will therefore have a great impact on his/her punishment and it shows the SSBPA see very different on the wrong-doings.

In short; Independence issue is a wrong-doing which the SSBPA rarely (in relation to the other types) penalise auditors for. Though, when penalised for, it is generally harsher than every other type of wrong-doing save one. Moreover, the same relation also exists between cases involving Conflict of interest and Independence impairment, where the former is more infrequent but punished harder than the latter.

Time periods

Table 5. Wrong-doing per year

<table>
<thead>
<tr>
<th>Wrong-doing</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
</table>

² Percentage of all cases

1 Percentage of the type of punishment within the total number of cases per individual wrong-doing.
The amount of cases involving independence issues can be separated into three periods 2004-06, 2007-09 and 2010 (see Table 5). In proportion to all cases the amount of independence issues has been in decrease. The most drastic drop is 2010 where only 3 of 45 cases (3.75%) are about independence breaches, far off from the “peak year” of 2005 where the same number was 19 of 52 cases (23.75%). One explanation for these periodic differences might be the independency issue was more in the spotlight during the earlier years of the time period and therefore the SSBPA put extra effort in searching for these types of wrong-doings and after a few years the “current” topic changed and another risk area was prioritised by the SSBPA. It could also be the auditors, as a result of the SSBPA’s work, started to take the independence issue more seriously (or they gotten better at hiding it). Lastly, there is also a possibility the rules regarding independence has become clearer and the auditor therefore better know how to avoid being in an independence impairing situation. Independence is arguably always a topic of interest (and perhaps more topical in 2010 than 2004) and the most likely of the scenarios is the auditors have started to take independency issues more seriously as an effect of tough punishments. This is also in line with the theoretical framework by Dillard and Yuthas (2002) which argued for the impact and effect actions taken by the regulatory agent would have on the audit community.

**Identifying an Impairment**

In regard of instigating cases the data shows the SSBPA view independence as an important topic. This is reflected in the data where disciplinary cases involving independence breaches are more than half of the time instigated by the SSBPA themselves, mostly through their quality controls. This is followed by Other with 17.07% and other instigators such as the STA and FAR (see Table 6). Johnstone et al. (2001) argue for the pivotal part a regulatory oversight has to maintain a high level of auditor independence and the study shows this is the case in Sweden. Moreover, comparing the ratio of instigating cases involving independence issues to all cases show the quality controls by the SSBPA (ratio 1.44) and FAR (1.77) contributes more in the former than the latter while third-party groups such as the SFSA (0.5), SNECB (0.45) and STA (0.37) does not contribute as much (see Table 6). However, Ashbaugh et al. (2003) state it is difficult for a third party to notice an independence issue and the groups on the inside (auditor and client) have no incentive to report it. that third parties (e.g. the STA) generally focus on other aspects of the auditor’s work and hence do not contribute as much to discover independence impairments. Solely focusing on instigating cases the data suggest the SSBPA are concerned with independence impairments however other information from the disciplinary cases suggest otherwise.

<table>
<thead>
<tr>
<th>Conflict of interest</th>
<th>8 (22.85%)</th>
<th>5 (14.29%)</th>
<th>7 (20%)</th>
<th>4 (11.43%)</th>
<th>5 (14.29%)</th>
<th>5 (14.29%)</th>
<th>1 (2.86%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence impairment</td>
<td>8 (14.29%)</td>
<td>17 (30.36%)</td>
<td>8 (14.29%)</td>
<td>8 (14.29%)</td>
<td>8 (14.29%)</td>
<td>5 (8.93%)</td>
<td>2 (3.57%)</td>
</tr>
<tr>
<td>Independence issue</td>
<td>13 (16.25%)</td>
<td>19 (23.75%)</td>
<td>14 (17.5%)</td>
<td>10 (12.5%)</td>
<td>11 (13.75%)</td>
<td>10 (12.5%)</td>
<td>3 (3.75%)</td>
</tr>
<tr>
<td><strong>All Cases</strong></td>
<td><strong>41 (12.13%)</strong></td>
<td><strong>52 (15.38%)</strong></td>
<td><strong>49 (14.5%)</strong></td>
<td><strong>56 (16.57%)</strong></td>
<td><strong>49 (14.5%)</strong></td>
<td><strong>46 (13.61%)</strong></td>
<td><strong>45 (13.31%)</strong></td>
</tr>
</tbody>
</table>
Table 6. Instigator\textsuperscript{12}

<table>
<thead>
<tr>
<th>Wrong-doing</th>
<th>FAR SRS</th>
<th>Other</th>
<th>SFSA</th>
<th>SNECB</th>
<th>SSBPA - Other</th>
<th>SSPBA - QC</th>
<th>STA</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conflict of interest</td>
<td>7 (20%)</td>
<td>4 (11.43%)</td>
<td>0 (0%)</td>
<td>1 (2.86%)</td>
<td>2 (5.71%)</td>
<td>18 (51.43%)</td>
<td>3 (8.57%)</td>
<td>35</td>
</tr>
<tr>
<td>Independence impairment</td>
<td>5 (8.77%)</td>
<td>11 (19.3%)</td>
<td>1 (1.75%)</td>
<td>0 (0%)</td>
<td>7 (12.28%)</td>
<td>27 (47.37%)</td>
<td>6 (10.53%)</td>
<td>57</td>
</tr>
<tr>
<td>Independence issue</td>
<td>9 (10.98%)</td>
<td>14 (17.07%)</td>
<td>1 (1.22%)</td>
<td>1 (1.22%)</td>
<td>8 (9.76%)</td>
<td>40 (48.78%)</td>
<td>9 (10.98%)</td>
<td>82</td>
</tr>
<tr>
<td>All Disciplinary cases</td>
<td>23 (6.22%)</td>
<td>111 (30%)</td>
<td>9 (2.43%)</td>
<td>10 (2.7%)</td>
<td>32 (8.65%)</td>
<td>74 (20%)</td>
<td>111 (30%)</td>
<td>370</td>
</tr>
<tr>
<td>Independence issue/All DC-ratio</td>
<td>1.77</td>
<td>0.57</td>
<td>0.5</td>
<td>0.45</td>
<td>1.13</td>
<td>1.44</td>
<td>0.37</td>
<td></td>
</tr>
</tbody>
</table>

As the data shows 60% of all times where an independence issue is discovered the investigation is based on a quality control (either by FAR or the SSBPA) which is about making a thorough assessment of the auditor’s work. In addition, 48.75% of all cases involving independence issues consist of 3 or more assessments compared to the average of 26.63% and in proportion to the average very few cases only involve 1 assessment (see Table 7). Furthermore, only 5.62% of all rulings consisted of only Independence issues (see Table 8). In line with previous discussion this can be interpreted as independence impairments are not often the reason why a disciplinary case is opened instead it is something discovered while reviewing the auditor. As this would mean independence breaches are most of the times noticed when the auditor makes another mistake this seemingly suggest the SSBPA does not view independence as a critical issue and they are more focused on other wrong-doings and when they discover an independence impairment it is more about coming across it then actively searching for it. However, as touched upon, it might also be independence impairments are simply difficult to notice unless the auditor makes another mistake which would also implicate there might be a potential large number of unknown cases.

Quality affecting issues contra Non-Quality affecting issues

The SSBPA view independence as an important attribute for an auditor and impairment is a severe issue when it reduces the audit quality. This is evident by comparing how the SSBPA punish different combinations of wrong-doings. In 11 of 161 cases (6.83%) the auditor lost his/her license due to wrong-doings only relating to a Quality issue (see Table 8). However, the combination Independence issues & Quality issues leads to a removal in 39.39% of the cases. In regard of toughest punishment this combination is at the top followed by the combination of all three categories. Furthermore, the combination Independence issues & Quality issues leads to more removals than Quality issues & Non-Quality issues both in percentage and in total numbers even though the latter consist of app. 50% more cases. This also suggests the SSBPA view independence as a critical aspect of what it means to be an auditor. However, pure Independence issues, where no other errors has been discovered except the impairment itself never leads to an auditor losing his/her license nor are they

\textsuperscript{1} See Appendix D for list of definitions
\textsuperscript{2} In this table there are 370 cases while as stated the empirical material consisted of 338 rulings. This is because when several disciplinary cases are filed against an auditor the SSBPA treat them as one disciplinary ruling for an accumulated punishment.
frequent (making up 5.62% of all cases studied). The combination of Independence issues and Non-quality issues neither lead to any removals and it is even more infrequent (only 5 cases consist of this combination). From the data it is thus possible to state independence impairment is a serious issue according to the SSBPA when it affects audit quality but taken lightly when it has no apparent influence on the auditor’s work. A distinction can therefore be made between two types of independence issues; Quality affecting (QA) and Non-Quality affecting (Non-QA). As presented in the Analytical framework, QA is an independence impairment which leads to errors beneficial for the client while Non-QA is not affecting the quality of the audit report and therefore not adversely affecting the external stakeholders. QA is the more harmful of the two types of independence issues which is reflected in the SSBPA’s much tougher treatment of these errors.

Table 7. No. of assessments (Mean = 2.57, Median = 1)

<table>
<thead>
<tr>
<th>Wrong-doing</th>
<th>1</th>
<th>2-3</th>
<th>3&lt;</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conflict of interest</td>
<td>6</td>
<td>9</td>
<td>20</td>
<td>35</td>
</tr>
<tr>
<td>Independence impairment</td>
<td>20</td>
<td>9</td>
<td>27</td>
<td>56</td>
</tr>
<tr>
<td>Independence issue</td>
<td>24</td>
<td>17</td>
<td>39</td>
<td>80</td>
</tr>
<tr>
<td>All Cases</td>
<td>183</td>
<td>65</td>
<td>90</td>
<td>338</td>
</tr>
</tbody>
</table>

QA issues are much more common than Non-QA issues and when the latter actually is discovered it is taken very lightly on. Therefore, a logical step would be to conclude this type of issue is not important according to the SSBPA. A bit worryingly though is previous studies have shown it is the perception of auditors’ independence which matters (e.g. Johnstone et al., 2001; Hodge, 2003; Krishnamurthy et al., 2006). A Non-QA issue does not impair the quality of the audit report per se but it decreases the credibility of the auditor’s work. This raises the question if the report holds any actual value if the stakeholders do not trust the information in it. As previously argued, it is difficult to notice independence impairments and the data suggest independence issues are most of the time discovered while investigating an auditor based on other errors he/she has done. This is evident as QA issues are the most common form of independence issues. Moreover, just because an auditor does not make any errors does not mean he/she is not biased, it could simply be the client’s financial reports are in order. If this hypothetical auditor would get caught his/her impairment would then be a Non-QA. Therefore, the potential large number of unknown cases probably falls under this type of independence issue.

Table 8. Type and punishment

<table>
<thead>
<tr>
<th>Type</th>
<th>Admonition</th>
<th>Warning</th>
<th>Removal</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence issue</td>
<td>8 (42.11%)</td>
<td>11 (57.89%)</td>
<td>0 (0%)</td>
<td>19 (5.62%)</td>
</tr>
<tr>
<td>Independence issue &amp; Quality issue</td>
<td>2 (6.06%)</td>
<td>18 (54.55%)</td>
<td>13 (39.39%)</td>
<td>33 (9.76%)</td>
</tr>
<tr>
<td>Quality issue</td>
<td>59 (36.65%)</td>
<td>91 (56.52%)</td>
<td>11 (6.83%)</td>
<td>161 (47.63%)</td>
</tr>
<tr>
<td>Quality issue &amp; Non-Quality issue</td>
<td>11 (22.45%)</td>
<td>30 (61.22%)</td>
<td>8 (16.33%)</td>
<td>49 (14.5%)</td>
</tr>
<tr>
<td>Non-Quality issue</td>
<td>28 (58.33%)</td>
<td>16 (33.33%)</td>
<td>4 (8.33%)</td>
<td>48 (14.2%)</td>
</tr>
<tr>
<td>Non-Quality issue &amp; Independence issue</td>
<td>1 (20%)</td>
<td>4 (80%)</td>
<td>0 (0%)</td>
<td>5 (1.48%)</td>
</tr>
</tbody>
</table>
The difference between QA and Non-QA are the direct consequences of the independence impairment but this is not the same as saying the intentions of the perpetrators are different. Therefore, the argument could be made the SSBPA should treat the same issues identically as it would have a positive effect on the auditing profession. However, as in most situations what sounds obvious in theory can be less so in practice. As Non-QA does not impair the factual quality of the audit report it seems harsh (perhaps even unfair) to punish an auditor with a warning or removal of license (which evidently never happens, see Table 8) for doing one mistake unrelated to the quality of his/her work. As a regulatory supervisor it is the SSBPA’s duty to ensure the public can have trust in the auditors but this responsibility must be carried out in a way which is fair for the auditors. Arguably an auditor should be allowed to make one misstep (especially if it does not affect the overall audit quality) without risk losing his/her job. Due to this the SSBPA’s own legitimacy could be hurt as the perception of their actions is that Non-QA is a minor issue.

A solution to the conflict between a fair punishment and maintaining the public confidence could be to treat independence issues in the same way as arson in criminal law. In Sweden it is enough to start a fire close to a building with no people nearby and still be sentenced for arson, a crime punished with a prison sentence, due to great risks with fires in inhabited areas. The same principle could be adapted by the SSBPA in regards of independence issues. By calling out on the inherent risks independence impairments could lead to it could be possible to legitimise harder punishments and thus restore the trust in the profession while still staying fair to the auditors. However, it should also be noted even though the SSBPA’s role is to supervise the auditors they do not make the laws and their decisions can be overruled. It is therefore possible the SSBPA view Non-QA as a more important issue than their actions suggest.

CONCLUSIONS AND CONTRIBUTION

Previous research has shown the importance of independence to uphold credibility in the auditor’s work and trust in the audit report and that independence impairment diminishes the value of the audit. Independence is a constantly topical subject, currently emphasised by the European Commission’s Green Paper on Audit. As governmental regulators have started to take a greater role in the audit community both in the U.S. and in Europe the purpose of this paper was to get increased insight on a regulator’s view on independence in a Swedish context with the aim to contribute to the research regarding auditor independence, phrased as the research question how do the Swedish Supervisory Board of Public Accountants act with auditors lacking independence? To find an answer 338 disciplinary rulings by the SSBPA from the years 2004-2010 were dissected, categorised and analysed. As with all methods this quantitative approach suffers from some limitations. As the study only consists of secondary data the thesis is not able to offer an increased understanding of the process the SSBPA goes through when investigating independence issues. Therefore, the research is limited in the aspect that it becomes somewhat assumptive in its design. Moreover, due to focusing on only
reading the disciplinary cases relevant information pertaining to the rulings but not in the text might have been left out.

The study shows the SSBPA is the most prominent party in regards of noticing independence breaches. They initiate by far the most cases and they also have the highest ratio of instigated cases regarding independence issues compared to all rulings. However, as most independence issues are discovered through quality controls where the auditor is guilty of several different wrong-doings implying independence issues are not the reason for starting a case but rather something stumbled upon. However, independence impairments are punished harder than the average wrong-doings thus signalling the SSBPA view them as a critical issue. However, this only holds true when the independence issue is paired with a wrong-doing related to the quality of the auditor’s work e.g. insufficient documentation, faulty audit reports and poor judgement in doing the audit. The review of the disciplinary cases show independence issues can be separated into two categories where in the SSBPA punish Quality-affecting issues severe while Non-QA are taken lightly on. The former is a practical proxy for Independence in fact (IIF) while the latter is for Independence in appearance (IIA).

The conclusion of the study is the SSBPA view IIF as one, if not the most, important attributes for an auditor while IIA is on the other side of the spectrum being one of the least vital. These findings are interesting as this is in stark contrast to the propositions made by the European Commission and SOX as they are more focused on mitigating issues related to IIA according to Tacket et al. (2004). Moreover, previous studies have shown it is the perception of auditor’s independence (i.e. IIA) which matter (e.g. Johnstone et al., 2001; Hodge, 2003; Krishnamurthy et al., 2006). This would seemingly indicate a discrepancy between the European Commission's view on what matters and the Swedish regulator's. As regulator, it is the SSBPA’s responsibility to ensure the trust in auditors is upheld. As their actions suggest independence only becomes a problem when it influences the quality there is a possibility the SSBPA’s view is not aligned with what is needed to maintain (or restore?) the public trust in auditors in regard of their independence level. The implication of this could be a continued scepticism regarding the audit profession. Moreover, this also highlights a fundamental issue; it is rather rational the SSBPA should view IIF as a more critical aspect than IIA. After all, in regard of the quality of the audit it is only affected by an independence impairment when it is a factual issue. An impairment of IIA does not reduce the quality per se and therefore the SSBPA's view is sound. However, as aforementioned impairment of IIA reduces trust which in the grander scheme of all is arguably as important. Moreover, if the governmental regulators do not share the European Commission's view it also stand to question the usefulness of the latter's suggestions and work. Therefore, IIA should perhaps be taken more serious as it is almost equally important as IIF but not as obvious.

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APPENDIX A

The Companies Act (2005:551)

According to 9:17 in the Companies Act the public accountant is assumed to have a conflict of interest and thus is not allowed to audit the company or its subsidiaries if he/she;
1. owns stock in the company or another company within the same group,
2. is a member of the board or the managing director of the company or its subsidiary, or if he or she assists in the company’s bookkeeping or administration of company assets, or the company’s control over such decisions
3. is employed by, or in some other way dependent on, the company or a person referred to in the 2nd paragraph,
4. is engaged in the same company as the person who assists professionally the company in its bookkeeping or administration of company assets, or the company’s control over such decisions
5. is married to or a cohabitant of, or a sibling or relative of a person who meets the criteria of the 2nd paragraph,
6. is a brother-in-law or sister-in-law of a person referred to in the 2nd paragraph or if one of the is married to the other person’s sibling, or if he or she
7. is indebted to the company or another company within the same group, or who has a financial commitment which such a company has guaranteed.

Moreover, in §18 of the same chapter it is stated the auditor is not permitted to hire anyone who is not allowed to audit according to 9:17. However, the auditor is allowed to use internal auditors as long as it is in accordance with the Swedish GAAP.

APPENDIX B

The Auditor’s Act (2001:883)

In §20 of the Auditor’s Act it reads an auditor should perform his/her task in an unbiased and independent manner and also take an objective standpoint. The audit operation shall be organised as to secure the auditor’s impartiality, independence and objectivity.

The auditor is also responsible to, prior to a job, assess if there are circumstances which might affect the credibility of his/her independence. According to §21 of the Auditor’s Act a public accountant should decline/resign if:

1. he or she, or anyone else in the network where that person is active
   i. has a direct or indirect financial interest in the contractor’s business,
   ii. has given advice on a question relating to the assignment in a situation which is not part of the auditing operation,
   iii. has taken a stance for or against the contractor’s standpoint in some form of legal or financial matter,
   iv. has close personal relations to the contractor or someone under the contractor’s management,
   v. has been subjected to threats or other forms of pressure aimed at inducing uneasiness, or
2. if there is another circumstance of such nature that it may damage the trust in the auditor’s neutrality or independence.
However, the auditor does not need to decline or resign if, in a single case, there are special circumstances or measures has been taken which results in removing all concern regarding his/her independence. Moreover, in accordance to §22 the SSBPA shall on the auditor’s request make a preliminary decision about whether a circumstance falls under any of the scenarios in §21 and if the auditor therefore should decline/resign. A preliminary decision is conclusive to the SSBPA in the auditor’s favour as long as the conditions remain unchanged. Lastly, in §22a it is stated a public accountant auditing a listed company shall annually present a report regarding his/her business.
APPENDIX C

Flow-chart of the Principle based model for independence by FAR.
APPENDIX D

Definitions:
FAR SRS – Professional Institute for Authorised Public Accountants
IIA – Independence in appearance
IIF – Independence in fact
NAS – Non-audit services
SFSA – Swedish Financial Supervisory Authority
SNECB – Swedish National Economic Crimes Bureau
STA – Swedish Tax Agency
SQT – Systematic Quality Control
SSBPA – Swedish Supervisory Board of Public Accountants
SOX – Sarbanes-Oxley Act

REFERENCES


