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AUDITOR INDEPENDENCE CHALLENGES AND ESTABLISHING AN OVERSIGHT ORGANIZATION INDEPENDENT OF PROFESSION IN COMPARISON WITH EUROPEAN REGULATIONS.

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Declaration

I declare that the work in this dissertation titled 'Auditor independence challenges and establishing an oversight organization independent of profession in comparison with European regulations' has been carried out by me in the Department of SCIENZE ECONOMICHE E AZIENDALI"MARCO FANNO. The information derived from the literature has been duly acknowledged in the text and a list of references provided. No part of this dissertation was previously presented for another degree or diploma at this or any other university.

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Chapter 1

Introduction

1.1 Preface

Although self-criticism is not common in a profession but it is essential for moving toward a consistent development in a clear environment. One of the professions which are exposed to public criticism in cases of financial scandal is independent auditing. Breakup of one of the biggest international audit companies with an experience more than 90 years and 100 thousands employee as a consequence of disclosing its role in a big scandal for an American firm (Enron) represents vulnerable position of auditing companies.This also shows importance of independent audits on trust level of investors.

Since 2002 (After the Enron event), governments claimed responsibility of quality controlling of audit projects. Since then more than 50 countries having free economy, established governmental institutions to monitor independent auditors. These independent Institutions are under authority of governments both from employee's side and financial aspect.
Here are 11 principles that will be briefly explained in Chapter 3 in detail:

1.1.1 Structure

Principle 1: The responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation.

Principle 2: Audit regulators should be operationally independent.

Principle 3: Audit regulators should be transparent and accountable.

1.1.2 Operations

Principle 4: Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed.

Principle 5: Audit regulators should ensure that their staff is independent from the profession and should have sufficient staff of appropriate competence.

Principle 6: Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements

Principle 7: Audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties.

1.1.3 Principles for inspections

Principle 8: Audit regulators should as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.

Principle 9: Audit regulators should ensure that a risk-based inspections program is in place.

Principle 10: Audit regulators should ensure that inspections include effective procedures for both firm wide and file reviews.

Principle 11: Audit regulators should have a mechanism for reporting inspections findings to the audit firm and ensuring remediation of findings with the audit firm.

1.2 Research Methodology

This chapter is about to ask partners and audit directors who mostly working for several audit firms based in Tehran and also ask audit directors who work for Audit Organization of Iran and Iranian association of Certified Public Accountants(secretary-General, high council members and other members in IACPA's committees) to fill some questionnaires and propose their opinion about this hypothesis.

1.3 Hypothesis

- The oversight organization must be independent?
- How should direct this oversight organization?
- Which structure should it has?
- How its financial requirements should be provided?
- Comparing the above answers with European regulations.

1.4 Statistical Population

Statistical population in current study is composed of independence auditors such as partners and audit directors who mostly working for several audit firms in Iran and also ask audit directors who work for Audit Organization of Iran and Iranian association of Certified Public Accountants.

1.5 Analytical approaches

In this chapter, as the questionnaire includes 'Yes' and 'No' questions, is used Pie charts that show the percentage of agreed and disagreed answers with each questions.

1.6 Terms and Definitions

Independence auditor: independence Auditor can be defined as a reference to the independence of internal or external auditors from parties that might have a financial interest in the business being audited.

Independence requires:

Independence of mind: The state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism.

Independence in appearance: The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional scepticism had been compromised.

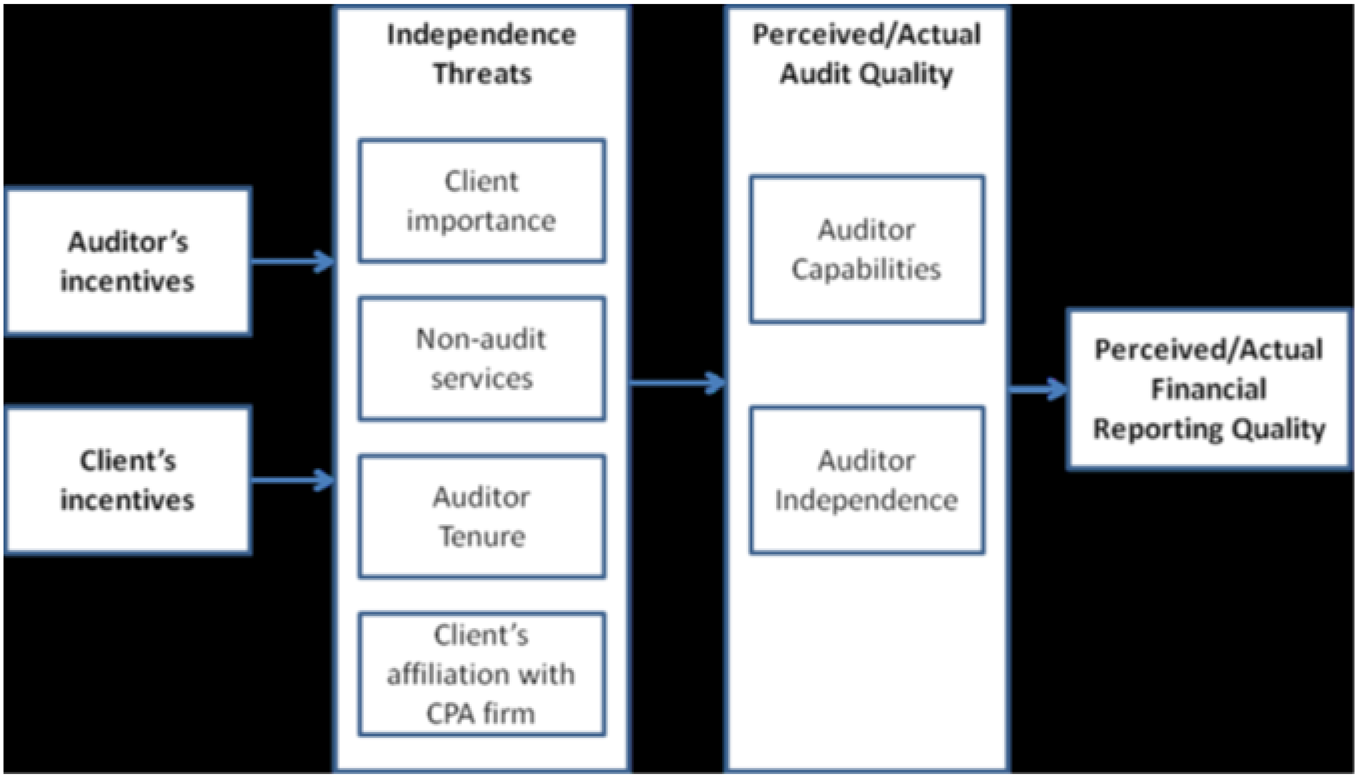
Chapter 2

Literature review

2.1 Threats for auditor independence

The review is structured based on the four main threats to auditor independence, namely client importance, non-audit services, auditor tenure, and client's affiliation with CPA firms. Auditor independence is important because it has an impact on the audit quality. DeAngelo (1981b) suggests that audit quality is defined as the probability that (1) the auditor will uncover the breach and (2) report the breach. If the auditor does not remain independent, auditor will be less likely to report the irregularities and hence, the audit quality will be impaired. Client importance involves the degree of auditors being economically dependent on the client. When providing service to the client, an audit firm receives remuneration from the client, resulting in auditors being financially bonded to the client (DeAngelo, 1981a). If the client constitutes a relatively large part of an auditor's portfolio, an auditor has an incentive to retain the client to warrant a future source of revenues and profits and therefore, to compromise independence and act in favor of the client (Blay, 2005). Non-audit services can also adversely affect auditor independence. When the external auditors provide non-audit service to the client, they receive more income, which may result in greater economic dependence, as discussed earlier. Furthermore, the joint provision of audit and non-audit service by the same auditor may cause conflict of interest since he may become less skeptical in reviewing his own work. Auditor tenure can lead

A Framework for Research in Auditor Independence and Audit Quality



to impairment of independence. As the auditor-client relationship lengthens, the auditor may develop close relationship with the client and become more likely to act in favor of management, resulting in reduced objectivity and audit quality. Client's affiliation with CPA firms involves the situation where part of the client's personnel used to work for the current auditor. The affiliation can cause impairment of independence from personal relationship between the client's officer and the auditor or the ex-auditor's acquaintance and circumvention of the audit methodology (Lennox, 2005).

2.1.1 CLIENT IMPORTANCE

In this literature there are many research methods that are associated with client importance. The studies that employ modeling techniques provide strong theoretical field for this research area. Also, there are many other studies that practice archival and experiment methods to support the theoretical arguments.

Auditors' incentives/benefits, perception, and behavior

The evidence on the effect of client importance on auditor's behavior is mixed. While a few earlier studies use different proxies to investigate the effect of economic dependence on the auditor independence, the studies in this area mainly use an auditor's propensity to issue qualified audit report. In an early study, Deis, Jr. and Giroux (1992) use quality control review findings as surrogate for audit quality. They find that audit quality increases with the number of the audit firm's client. Wright and Wright (1997) apply the decision to waive audit adjustment and indicate that auditors are more likely to waive audit adjustment as the client size increases. Magee and Tseng (1990) indicate that, without contingent audit fees and binding multi-period commitment, the value of incumbency can negatively affect auditor independence only if: (1) there is a disagreement on appropriate reporting policy and (2) the reporting disagreement between auditor and client cover more than one reporting period. On the other hand, positive value of incumbency will not lead to a compromise of independence but to the client-initiated changes, if the reporting disagreement is important for either the client or the auditor. However, when considering the direction of income effect, they do not find clear evidence of bias towards larger clients. Krishnan and Krishnan (1996) report that, given that the client deserves a qualified opinion, auditors are less likely to issue the qualified opinion when a client's decile position in the auditor's portfolio is higher. An experiment, likewise, also suggest that auditors facing a high level of independence threats are less likely to reach a going concern opinion (Blay, 2005). Craswell, Stokes and Laughton (2002), on the other hand, do not find significant association between auditor fee dependence and the propensity to issue qualified audit report in Australia. On a partner level, Trompeter (1994) and Carcello, Hermanson, and Huss (2000) find that the economic position of the client has a negative consequence on the partner independence. Trompeter reports from his experiment that partners in firms with compensation scheme closely tied to client retention are less conservative in downward adjustment to income. Carcello, Hermanson, and Huss, from an archival study, find that partners in small-pool audit firm are more likely to be affected by client size than those in large-pool firms when considering going-concern issues.

Clients' incentives/benefits, perception, and behavior

Much of the research related to economic dependence place a major concern on auditor's part and very little has been done on clients' perspective. Which perhaps could be understood as the client would have an inherit leaning to the result of the audit.

Financial reporting quality

Gaver and Paterson (2007) researched the effect of economic dependence on the financial reporting quality of the non-life insurance companies. They find that although financially weak non-life insurers tend to understate their loss reserve, the magnitude of understatement decreases with the economic significance to the local practice office of the auditor.

Users' perception and behavior

Khurana and Raman (2006) study the association between ex-ante cost of equity capital and client's relative size in office and national firm level. They report that investors view economic dependence on the client, as reflected in cost of equity capital, negatively. Moreover, his results also suggest that auditors are perceived to be less likely to resist client pressure when audit clients had better financial condition. Pany and Reckers (1980) find that size of the client, defined as one percent and ten percent of the office revenue, is not perceived as impairing auditor independence but even a small number of gifts and purchase discounts are noticed as decreasing auditor independence. In Knapp's (1985) study, loan officers remark that high competition in the audit service market somewhat reduces the perceived likelihood of auditors to resist client pressure in audit conflict.

2.1.2 NON-AUDIT SERVICES

For the concept of independence of the auditor, there are many studies most of which have focused on the external auditor's provision of non-audit services. These investigations include various research techniques and methods: archival, survey, experiment and modeling.

Auditors' incentives/benefits, perception, and behavior

Providing a non-audit service to the clients has economic motivation for some auditors (marketing incentives!). Generally, non-audit services are considered as more economical. In an experiment conducted by Dopuch and King (1991), it is found that forcing an auditor from providing ensemble audit and non-audit services does not bring in improved efficiency; however, it might lead to auditors' selection of non-audit over audit service. On the other hand, Asare et al. (2005) reported opposite indications. Their results show that auditors' decisions in choosing the service is not a function of non-audit service engagement. Knowledge spillover is another factor discussed in existing literature related to the auditors' incentives toward various types of audits. For instance, Simunic (1984) showed that the joint provision of audit and non-audit service may bring about transfer of knowledge between the performed services. In another work, Beck and Wu (2006) performed a modelling approach illustrating that that appropriate amount of non-audit services might help auditors decrease earnings uncertainty. As a consequence, the quality of the audit improves. In this way, auditors may be inclined toward conducting non audit service (NAS) without charging the client (marketing incentives and having that audit project for several years). The association between audit and non-audit fees has been the subject of many studies in the literature. Briefly, results have indicated that substantial association between the two types of fees represents the pricing effect of knowledge externality between the services. However, there are some discrepancies in the evidences. While results from some investigations show a positive association between audit fees and either provision or magnitude of non-audit service (e.g. Simunic, 1984; Simon, 1985; Palmrose, 1986), the other group of studies show no such an association exists (c.f. Abdel-khalik, 1990; Whisenant et al. 2003) Conversely, the archival approaches on pricing influences do not provide direct evidence of knowledge transfer, which might need the further studies (see Joe and Vandervelde, 2007). These methods are applied mainly because it is not straightforward to obtain the actual evidence of knowledge externality.

Davis and coworkers, (1993) reported that there is a weak evidence of positive association between audit effort and NAS fees but no prominent evidence of association found between non-audit and audit fees. Joe and Vandervelde (2007) performed an experimental study in which their findings show that there is a significant evidence of knowledge spillover when the same auditor conducted both audit and non-audit services; however, it is not the when the auditor had access to non-audit service working papers. These researchers also mentioned that the joint provision of audit and non-audit services by the same firm lead to fewer frauds identified by the auditor. Hence, whether auditors actually receive benefits from knowledge transfer between both services is still not clear. About the archival evidence on the auditor's behavior, the related studies use the propensity of the auditors to issue going concern opinion to investigate whether the auditors lose their objectivity as a result of non-audit service provision. Observations are mostly consistent with no significant evidence of adverse effect of non-audit service on propensity to issue going concern opinion (e.g. DeFond et al. 2002; Geiger and Rama, 2003). Conversely, Lim and Tan (2008) have found that issuance of going-concern audit report is more probable when the level of non-audit services requested from industrial partners increase.

Clients' incentives/benefits, perception, and behavior

Alongside auditors, clients have incentives as well to purchase non-audit services from their external auditors. Most importantly, the Public Oversight Board (POB) (1979) states that clients may be able to save costs and receive higher quality service from their own auditors. If clients acquire the non-audit services from other firms with no prior knowledge about the client's business, understanding client's businesses and providing proper service probably takes longer time and more works from the client's personnel to deal with the new service provider. Moreover, since other auditors may require more time and effort, they might charge more for their services. As a matter of fact, not all clients prefer to have the service from their own external auditors. In accordance with the agency theory, companies need independent audit to decrease the agency costs. Clients with high agency costs may be less willing to obtain non-audit services from their own auditors because it can lead to reduction in perceived independence, audit quality and monitoring value of the audit service (Parkash and Venable, 1993).

Some literature studies provide evidences regarding the auditee's incentive for non-audit service order from their auditors. Among them, Scheiner and Kiger (1982) have reported that non-audit services purchased by companies are found to be function of audit firm, client's industry, trading exchange, and sales. Parkash and Venable (1993) suggested that demand for recurring NAS is related to agency costs and auditor specialization; however, orders for non-recurring NAS generally is not attributed to agency costs. In a work consistent with the agency theory, Firth (1997) reported that firms with higher agency costs had significantly lower magnitude of non-audit service purchases from their external auditors. Moreover, researches in this field include various parties of the client firm. As far as shareholders are concerned, most studies available in the literature have worked on the relation between the magnitude of non-audit service and the shareholder's approval of the auditors. For instance, Glezen and Millar (1985) concluded that the implementation of ASR No.250 and the magnitude of NAS are not connected with the reduction in auditor approval ratios. However, later studies indicated the opposite. For instance, Raghunandan (2003) stated that "the proportion of shareholders not voting for ratification is positively associated with the magnitude of non-audit fees". In another work, Raghunandan and Rama (2003) illustarted that in the presence of high non-audit fee ratio, shareholders are less probable to vote against ratification of the external auditor when the audit committee consisted only independent members. Mishra et al. (2005) suggested that the voting might be a function of the type of non-audit services. They found that audit-related fee ratio is negatively related to the proportion of shareholders' voting against auditor ratification while tax-service and other service fee ratios exhibit positive relations with the proportion of the same votes. Other works available in open literature include approval of the non-audit services by designated parties. In the pre-Sarbanes-Oxley Act (SOX) period, Pany and Reckers (1983) found that directors perceived non-audit services as impairing auditor independence and are less likely to approve such services when the magnitude of past or currently proposed non-audit service is high or when proposal involved system design services. The subsequent investigations after the implementation of the SOX typically include the association of audit committee and the non-audit service. Abbott and coworkers' (2003) results show that firms having full independent audit committee, with meetings at least four times a year, have lower magnitude of NAS purchase. Gaynor et al. (2006) suggested that audit committees are more prone to pre-approve risk management services if they find that audit quality will enhance. Unlike investors, audit committees are less likely to propose joint provision if the fee disclosure is needed in spite of the fact that joint provision generally leads to better audit quality. Abbott et al. (2007) have proved that the presence of audit committee with independent, active, and financially expert features is adversely connected to the magnitude of outsourcing routine internal auditing activities to the external auditor.

Financial reporting quality

There have been quite a number of studies using accruals as substitute for financial reporting quality. However, the presented evidences seem not to be conclusive. Frankel and coworkers (2002) find that NAS fees are positively associated to discretionary accruals. On the other hand, some evidences suggest no significant corresponding connection (e.g. Ashbaugh et al. 2003; Chung and Kallapur, 2003; Huang et al. 2007; Mitra, 2007). Reynolds et al. (2004) found that the positive relation presented by Frankel et al. is applied to only a subset of firms in their sample. Having controlled initial public offering and recent asset growth, the association between non-audit service and accruals was not found significant.

A few studies provide additional evidences on the variables moderating the connection between non-audit service and magnitude of accruals. For instance, Larcker and Richardson (2004) found a negative relationship between the magnitude of total fees and accruals using the latent class mixture model. Moreover, they concluded that the negative relationship is the most stringent for weak governance firms. Gul and coworkers (2007) have reported that non-audit fees are direct functions of discretionary accruals in the case of a short auditor tenure and a small client size.

Besides accruals, the restatement as a surrogate for low financial reporting quality was used by Kinney et al. (2004). They report that there is no prominent evidence of relationship between fees for financial information system design and implementation or internal audit services. However, the corresponding findings indicate that there are some statistically important evidences of positive connection between audit fees, audit-related fees, and unspecified non-audit fees and a negative relation between tax service fees and restatement. Restatement and the propensity of firms being subject to public or regulatory investigation in the UK were studied by Ferguson et al. (2004) using both as proxies. They have found that non-audit services bring about low financial reporting quality. In another work, Ruddock et al. (2006) employed the conservatism of earnings for this purpose. However, they have not reported that higher magnitude of non-audit services lead to reduction in conservatism. Moreover, association between higher non-audit fees lower accrual quality have been demonstrated by Srinidhi and Gul (2007). Finally, Zhang and coworkers (2007) have mentioned that the likelihood of internal control weakness disclosure is augmented with the audit fee ratio.

Users' perception and behavior

The external auditor's provision of non-audit services may make the financial statement clients cast doubtful with respect to the financial reporting quality. The users might become conscious of economic dependence on the client as reducing auditor's objectivity and, as a consequence, the quality of financial reports (see Kinney et al. 2004). Perceptions of financial statement users on the non-audit service provision are significant factors because the perceptions may influence the decision making. For instance, the influences can include loan granting and investment decision (e.g. Lavin, 1977; Dykxhoorn and Sinning, 1982; Lowe et al. 1999).

Early evidences largely include the surveys of users' perception on auditor independence in the case the auditor offers the joint provision of audit and non-audit service. Findings of the corresponding investigations available in the literature illustrate that the perception of objectivity on non-audit service is, mainly, a function of various non-audit services provided by the auditor. To cite a few, Lavin (1976, 1977) reports that EDP services are not viewed by loan directors and financial analysts as impairing auditor independence. He also found that that payroll services are perceived by loan directors as reducing auditor's objectivity. However, loan directors and research financial analysts are not in a general agreement about the influence of accounting services provision. The study of Shockley (1981) show that audit firms providing management advisory service to their clients are perceived by bankers and financial analysts to be more probable to lose their independence. Another work results concluded that involvement of auditors in internal audit-related management function had a substantial negative effect on loan officers' perception of auditor independence, financial statement reliability, and loan approval (Lowe et al. (1999)).

There are also other factors affecting the relation between the non-audit service and the auditor independence including the types of groups of users and staffing for the services.

Regarding the groups of users, Reckers and Stagliano (1981) have stated that professional users are less concerned than naive users about independence issue imposed by auditors' provision of NAS. As for staffing issue, auditors are typically assumed to be less independent in the case that there is no separation between staff performing the audit and non-audit service. (Lowe and Pany, 1995; Lowe et al. 1999; Swanger and Chewning, 2001)

Apart from the aforementioned surveys, the related works available in open literature include studies of the effect of non-audit service on the behavior of the users, generally those in the equity and debt markets. With respect to the equity market, the empirical works mainly focus on the influence of non-audit service magnitude on abnormal returns or earnings response coefficients. Specific studies found no relationship between the magnitude of non-audit services and the capital market proxy (e.g. see Chaneyand Philipich, 2002; Ashbaugh and coworkers, 2003).

On the other hand, majority of evidences are consistent with the negative market reaction to the level of non-audit service in various circumstances. For instance, the fee disclosure date (Frankel et al. 2002), quarterly earnings announcement (Francis and Ke, 2006) and key circumstances leading to the passage of Sarbanes-Oxley Act (Jain and Rezaee, 2006; Zhang, 2007).

Other group of investigations available in the literature illustrates that non-audit service decreases the informativeness of earnings perceived by the investors. For instance, Krishnan and coworkers (2005) have reported that there is a substantially negative relation between non-audit fee-based measures and earnings response coefficients in 2001, which is the initial period of non-audit fee disclosure. Limited evidence of adverse association of abnormal non-audit fees and earnings response coefficients was discovered by Higgs and Skantz (2006). However, Lim and Tan (2008) have indicated that earnings response coefficient soars with the level of non-audit services acquired from industry specialists. Regarding the user's behavior in the debt market, the existing literature works suggest that non-audit service has a negative effect on either the bond's ratings or cost of debts. For instance, Brandon et al. (2004) concluded that there is a negative relation between the magnitude of non-audit service and audit rating of client's bond. Furthermore, they reported that addition of non-audit service proxy in the bond ratings model did not result in better classification accuracy of the applied model. Finally, it was found, in a recent work of Dhaliwal and coworkers (2008), that the cost of debt is a positive function of the magnitude of non-audit fees for investment-grade firms.

2.1.3 AUDITOR TENURE

Studies have shown that there are two opposite sides in viewing the relationship between the auditor tenure and the quality of the audit. One side suggests that the longer the auditor keeps the relationship with their clients, it is likely that the relationship may evolve to a closer friendship which may result in reducing the quality of the audit. Due to the intimate relationship it is also likely that the auditor may take sides of the management. Another way of looking at this scenario is that as the relationship prolongs, the auditor develops a better knowledge of the business and will implement their expertise to its highest, resulting in higher audit quality. According to the survey studies and credible literature on the topic of auditor tenure and its audit quality, it is known that there is conflicting evidence supporting both views.

Auditors' incentives/benefits, perception, and behavior

According to the auditor tenure studies, the findings show conflicting aspects of this matter. One side suggests no association amongst the tenure and auditor's behavior. As per the study on auditor's perception, Shockley (1981) advises that within the five-year term, no changes have been reported in quality of the auditor's incentives. Another study that supports the fact that there are no variations in the behavior of the auditor with the prolonged tenure is the Knechel and Vanstraelen (2007). This study was ran by a company that eventually underwent bankruptcy. Contradictory study done by Deis and Girouz (1992), suggests a decrease in audit quality as the relationship of the auditor-client relationship lengthens. This study was based on quality control findings which represent that the auditor's quality of work may be in jeopardy as the relationship with he client strengthens. A study made by Carey and Simnett (2006) in agreement with Deis and Girouz, find that in Australia a seasoned audit partner tenure is conflicted with issuing a going- concern report due to the established relationship with the client.However, in the United States of America, it is knows that the most audit report failures happen to occur in the early stages of the auditor- client relationship (Geiger and Raghunandan, 2002)

According to research study Bamber and Iyer's (2007), the incentive of the auditor may contradict with the audit firm itself. The study shows that senior audit partner tenure with the client increases the chances of the auditor to abide to client'd preferences. It is likely for the auditor to comply with the client's requests and provide false reports. Bamber and Iyer also noted that unlike the auditor, the firm will stay their ground and will remain independent just to secure their reputation.

Clients' incentives/benefits, perception, and behavior

There has been limited evidence on clients' incentives, perception, and behavior related to auditor tenure and available findings are mixed. Consistent with the learning-curve effect argument, Knapp (1991) finds that audit committee perceives that auditor tenure affects the likelihood of auditors discovering material errors. His findings indicate that auditors with tenure of between five and twenty years are perceived as being more likely to discover material errors than those with zero to five-year experience with the client. Contrary to the perception-related study, research on client's incentives and behavior suggests otherwise. Carey and Simnett (2006) report that, in Australia, long audit partner tenure is associated with higher incidence of just meeting earnings benchmarks, indicating that client firms incur some benefits from maintaining long-term relationship with the auditor. Omer, Bedard, and Falsetta (2006) state that the level of tax services purchased by the client and probability of client voluntarily disclosing tax fee tend to increase with auditor tenure.

Financial reporting quality

Most empirical evidence on the effect of auditor tenure is consistent with longer audit tenure not resulting in lower financial reporting quality. The majority of studies use the magnitude and other forms of accruals as a surrogate for financial reporting quality. Myers, Myers, and Omer (2003) apply the dispersion of accruals as a proxy. They report that as auditor tenure lengthens, the discretionary accruals and current accruals are less dispersed, suggesting higher earnings quality. Carey and Simnett (2006) use the magnitude of abnormal working capital accruals and find no evidence of association between long audit partner tenure and the accruals. Chen, Lin, and Lin (2008) cover performance-adjusted discretionary accruals on their study of audit partner and audit firm tenure. Their results indicate that performance-adjusted discretionary accruals decrease with audit partner tenure and absolute discretionary accruals decreased with audit firm tenure, after controlling for audit partner tenure. Apart from accruals, Stanley and DeZoort (2007) utilize restatement as a proxy for low quality of financial reports. Their test results also suggest that as thelength of auditor-client relationship increased, the likelihood of restatement decreased, suggesting better financial reporting quality. Several other studies report results consistent with the notion that in early years, the auditors still need time to develop their understanding of the client's business and operations, so the quality of financial report may be lower in the early years of engagement. Johnson, Khurana, and Reynolds (2002) report that the quality of financial reports, represented by unexpected accruals and persistence of accruals, is lower for companies with short-tenure audit firms as compared to those with medium-tenure audit firms. However, they find no evidence of lower quality of financial reports for firms with long-tenure audit firms. Similarly, a study by Carcello and Nagy (2004) indicate that firms are more likely to receive AAER in the early years of auditor-client relationship but there is no evidence of higher propensity to receive AAER for long auditor tenure. Jenkins and Velury (2008) suggest that conservatism in reported earnings increases between short and medium tenure but does not change between medium and long tenure.

Users' perception and behavior

Previous literatures mainly suggest that the financial statement users do not perceive longer tenure as impairing auditor independence. Based on the survey of perception of bankers and financial analysts, Shockley (1981) concludes that auditor's tenure exceeding five years is not significantly perceived as reducing auditor independence. Ghosh and Moon (2005) find that longer tenure is associated with better earnings quality perceived by equity market investors, as reflected in earnings response coefficients. Their results also suggest that the effects of earnings on stock rankings and analysts' forecast increase with auditor tenure. The evidence related to the debt market indicates either positive or no effect of auditor tenure on debt market participants' perception. Mansi, Maxwell, and Miller (2004) find that longer audit tenure is associated with lower cost of debt financing in the bond market and such association is more pronounced for noninvestment-grade firms. However, results from Ghosh and Moon (2005) suggest that auditor tenure does not influence debt market analysts' perception of earnings quality. Fortin and Pittman (2007) when considering the debt pricing of the private firms, report no significant association between the length of auditor-client relationship and the yield spread of the private companies. Recent study by Boone, Khurana, and Raman (2008) suggest that the relationship between auditor tenure and investor perception of auditor independence, is non-linear. They find that the equity risk premium decreases when the tenure become longer in early years but tends to increase after 13 years. Although the evidence concerning the financial statement users mostly covers the audit firm tenure, Kaplan and Mauldin (2008) investigate the professional investors' perception related to audit firm and audit partner tenure. They report that there is no significant difference in independence perceived by non-professional investors between audit firm and audit partner rotations. More importantly, the non-professional investors perceived that strong audit committee can help strengthen auditor's independence.

2.1.4 CLIENTS' AFFILIATION WITH CPA FIRMS

There are three likely problems that could lead to impairment of auditor independence with regard to client employment issue Which was mentioned by Imhoff (1978): (1) auditor may view client as the potential employer; (2) the closeness with management may create a distance between the auditor and shareholders, who are in fact the real employer of the auditor; and (3) the audit team may have difficulty in maintaining independence while dealing with their former colleagues. These problems may affect objectivity and audit quality. There is limited evidence on the affiliation issue, compared to other causes of independence impairment due to the affiliation incidence is less prevalent than generally expected (Francis, 2004).

Auditors' incentives/benefits, perception, and behavior

There are some studies that inspect the auditor-client employment issue from the auditor's perspective. Imhoff (1978) is the first to conduct a study of independence issues related to auditor-client employment (Kaplan and Whitecotton, 2001), which reports that auditor's employment by the client is not an uncommon practice. Also, he finds that CPAs are less analytical than the financial statement users with regard to independence concern. It shows that the difference in such perception is caused by the time lapse between auditing and employment by the client, and the rank of ex-auditor. Auditor noticed auditing supervisor with 6-month time span between auditing and client employment as independent while pecuniary statement users apparent otherwise.

Kaplan and Whitecotton (2001) examine the independence concern associated to the potential employment relationship which appears during the audit commitment. They examine the auditor's reporting intention when the audit manager is offered client employment. They use unrestricted experiment for the auditors concerning the elements affecting the intention to report the employment offer to the audit partner. As a result, the auditor has greater intention to report the audit manager's potential connection with the client when observed personal costs of reporting are lower or when perceived personal responsibility for reporting is higher. The independence issues where executive officers are affiliated with audit firms by Lennox (2005). This study includes the common relationship that the client hires the auditor (alma mater affiliated), and the Casey where the company hires the officer's former firm as the auditor. He assumes that auditors are more likely to issue clean audit opinions to companies with either employment or alma mater affiliated executives than to unaffiliated client firms.

Clients' incentives/benefits, perception, and behavior

Building on the pervious discussion, one can realize the benefit of companies affiliating to an audit frim. Lennox (2005) states that audit firms' affiliation with their clients through Alma matter affiliation or employment affiliation increases the chances of receiving a clean audit. Furthermore, due to this affiliation and the clean audit report, the affiliated companies' executives' turnover reported to be lower than those unaffiliated companies, which indicates the appreciation and the recognition of affiliations benefits. More studies such as Bamber and Barfield (1997) recognizes that former employees of the company who became auditors can be affected by their Alma Matter affiliation. Companies usually try to strengthen and keep the relationships with their former employees and recognize them to affect the audit opinion. Alma matter affiliations creates a challenge for transparent auditing process.

Financial reporting quality

Literature and studies are conflicting about clients' affiliation with CPA firms. For example, Menon and William (2004) indicates that clients who have employment affiliation with officers or directors reports higher accruals than other institutions without the latter affiliation. On the other both studies Lennox, and North (2008) and Geiger, North, and O'Connell (2005) showed no effect of affiliations on financial reporting qualities.

Users' perception and behavior

Some studies show evidence on the independence issue initiated from outplacement of alumni in client firms. As mentioned previously, financial statement users seem to observe independence problem more critically than CPAs, due to the time span between auditing and working for a client firm and the rank of the auditor (Imhoff, 1978). However, Geiger, Lennox, and North (2008) believe that the rotating door appointment may also be beneficial to companies, through the knowledge and expertise of the ex-auditor. Their event-study findings show that the stock market viewed the appointment of firms' external auditors as their accounting and finance officers positively for smaller firms.

CONCLUDING REMARKS AND FUTURE RESEARCH

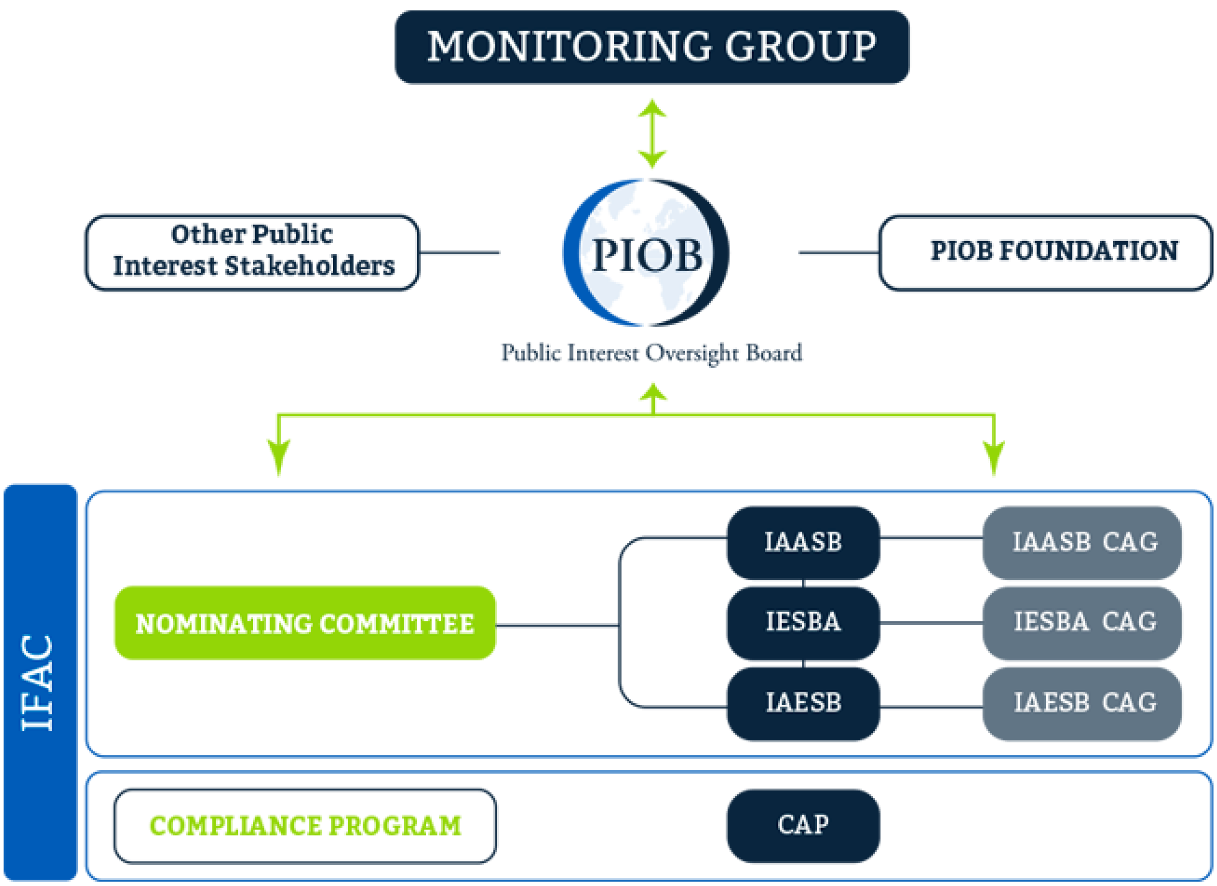
The research on auditor independence in relation to audit quality has received considerable attention due to its significance to the auditing profession. In addition to recent changes in the auditing profession, our literature review shows that inconclusive evidence warrants further studies for auditor independence and audit quality issues. The following points provide some guidelines for future research in this area. Firstly, as literature in this area, especially the archival ones, depend largely on the U.S. data, it may be useful to extend future research to cover evidence from other countries. This is because the United States are generally recognized as extremely litigious environment. Using other countries with less litigious environment would provide the settings in which the litigation effects are reduced and the reputation effects can be better observed. Moreover, like financial accounting research, research concerning auditor independence and audit quality may benefit from cross-countries comparison. People in different countries are likely to have different attitude and culture. As far as the auditing is concerned, the incentives, perception, and behavior of the auditors, clients, and financial report users in various countries may differ. Arnold, Bernardi, and Neidermeyer (1999), for example, performed an experiment on Big6 auditors from seven European countries. They found that there is some evidence of association between individualism and litigation, and the auditor's consideration to perform additional audit work. Previous client importance studies are mostly performed at the national and office level. However, the decisions for audit engagement are practically made at the partner level. As some evidence suggests that partner compensation scheme affect auditor independence (e.g Trompeter, 1994), more studies on the partner level may help provide additional contribution to the literature. Likewise, the majority of the tenure research is devoted to audit firm level. Nevertheless, recent auditor tenure studies report that audit partner tenure, as well as audit firm tenure, affects financial reporting quality (e.g Chen, Lin, and Lin, 2008). Also, further research on audit partner tenure may help better justify the audit partner rotation required in many countries. Finally, researchers can continue to generate future research questions around the requirements of the Sarbanes-Oxley Act, many of which aim towards auditor independence. The law has been in effect for over five years. This provides a good opportunity to perform related studies with less concern on limited sample size and higher generalizability across time periods. For instance, the Sarbanes-Oxley Act requires firms to rotate their auditors every five years, hence, by now, the sample consisting of all listed firms subject to mandatory rotation is available for investigation.

2.2 Does Selling Non-Audit Services Impair Auditor Independence?

One of the most hotly debated audit independence issues has been the provision of non-audit services (NAS) by audit firms to their audit clients. Strong arguments have been made that such services create an economic bond between auditor and client, impairing an auditor's independence. On the other hand, equally strong opinions have been expressed that the provision of NAS increases an auditor's knowledge of the client's business, resulting in a more effective audit. The debate over what is an acceptable scope of services that an audit firm should offer to audit clients has been going on for over three decades. An early discussion of the subject was Cowen (1980). Hall (1988) examines the alleged loss of independence due to the expansion of auditors' scope of practice to include non-audit services. In general, early regulatory efforts by the Securities and Exchange Commission (SEC) were greeted with skepticism. Many questioned if auditor independence was affected by the selling of NAS. There were additional concerns that restrictions on NAS could harm the economic viability of audit firms. However, others argued that the substantial sums paid by audit clients to their audit firms for NAS could create an economic bond that inevitably impairs audit firms' independence. The spectacular accounting failures of Enron, WorldCom, and others in the early 2000s refocused this debate and resulted in two regulatory efforts that substantially changed the provision of NAS by audit firms. First, the Sarbanes-Oxley Act (SOX) prohibited the provision of most types of NAS to audit clients. Second, in 2003, the SEC issued Rule No. 33-8183 (SEC 2003) that prohibited audit partner compensation that rewards the sale of NAS to audit clients. This rule was created in response to the SEC's concerns that audit partners' compensation plans created pressure on partners to generate incremental NAS revenue from audit clients, negatively affecting their independence. Despite the research consensus and the often expressed skepticism by auditors of the restrictions on the provision of NAS, many continued to express the belief that the provision of NAS by auditors leads to lower quality audits. Of particular concern were the compensation practices in the audit profession prior to the SEC prohibition in 2003. Prior to that time, audit firms routinely based the granting of partnership shares, and the resulting level of compensation, on the degree to which audit partners generated new NAS revenues from their clients. Art Wyatt (2003), a former senior partner at Arthur Anderson noted, "Cross-selling of a range of consulting services to audit clients became one of the most important criteria in the evaluation of audit partners. Those with the technical skills previously considered so vital to internal firm advancement found themselves with relatively less important roles." Coffee (2006) commented that partners who successfully attracted large NAS contracts through their salesmanship abilities replaced more technically proficient audit partners who were less successful at selling NAS. If audit partner compensation created strong incentives to bring in new NAS revenues from audit clients, then the threat to auditor independence may not have been from existing high levels of NAS, but from the potential for gaining additional NAS-related revenues in the future Goldwasser (2002) articulated this idea when he stated, "Moreover, the threat is not the non audit fees that the firm has received from the client, but rather the possibility of earning such fees in the future. An accountant who hopes to obtain a large non audit engagement is in greater jeopardy of impaired objectivity than one who has just completed and been paid for such an engagement." Similarly, Coffee (2006) notes his concern that the conflict of interest associated with NAS "lies not in the actual receipt of high fees, but in their expected receipt. Even the client currently paying low consulting revenues to its auditor might reverse this pattern if the auditor proved more cooperative."

2.3 Public Interest Oversight Board (PIOB)

The global architecture of standard setting in the field of audit, assurance, ethics and education consists of a three-tier structure made up of standard setting boards supported by International Federation of Accountants(IFAC), independent oversight (PIOB), and accountability to a monitoring body of public authorities (Monitoring Group). The objective of this collaborative model between the profession (IFAC) and the international regulatory community (MG) is to produce high quality global standards that are responsive to the public interest. The architecture attempts to balance the contribution from the profession to standard setting –which helps ensure the high quality and applicability of standards- against important checks that help ensure the public interest responsiveness of these standards, chiefly amongst which is the PIOB. The Public Interest Oversight Board is the global independent oversight body that seeks to improve the quality and public interest focus of the international standards formulated by the Standard Setting Boards supported by the International Federation of Accountants in the areas of audit and assurance, education, and ethics. Through its oversight activities, the PIOB works to bring greater transparency and integrity to the audit profession, thereby contributing to the enhanced quality of international financial reporting. The PIOB provides independent oversight throughout the entire process of standard setting to help ensure that standards development is fully responsive to stakeholder needs, accountable and transparent. The Public Interest responsiveness of standard development requires aligning the priorities of the profession with those of all stakeholders. This is the ultimate objective of the current architecture in place, of which the PIOB is an essential component. Independent oversight is necessary for financial markets: investors want to know that the financial information on which they base their capital allocation decisions is credible and reliable. By overseeing the establishment and adherence to high-quality professional standards, the PIOB seeks to further the international adoption and implementation of such standards and improve the comparability of financial statements across the globe.



ORIGINS OF THE PIOB

The PIOB was created in 2005 after a series of high-profile corporate scandals undermined the publics confidence in the credibility of independent audit opinions. The quality and integrity of financial information was proven key to market confidence and financial stability, and the crisis underscored the need for high quality and broadly applicable international accounting and audit standards that would work towards strengthening and bringing consistency to financial reporting around the world. The corporate scandals at the turn of the 21th century, including the Enron and WorldCom episodes in the US, and the collapse of Parlamat in Europe, were widely perceived as audit failures. These audit failures brought about a lack of trust in the information underpinning the workings of stock exchanges around the world and contributed to the financial instability of the early 2000s. International regulators and other entities, including the International Organization of Securities Commissions, the World Bank, the Basel Committee on Banking Supervision, and the International Association of Insurance Supervisors, responded to the crisis by calling for measures that would effectively address concerns about the audit process and the conduct and competence of audit practitioners. The European Commission and the International Forum of Independent Audit Regulators joined the MG as permanent members at a later stage. The accuracy, integrity, comparability and public interest focus of financial accounts were seen as key to reestablishing a stable and international financial system.

The IFAC Reform

In response to the crisis, the international regulators and the International Federation of Accountants agreed in 2003 on a blueprint for reform of the IFAC's standard-setting and compliance activities that was designed to manage the inherent conflict of interest caused by the profession setting its own rules. The aim of the reform was to enhance the quality of the standards governing the audit profession, improve the process by which they were formulated and reinforce the IFAC's commitment to serving the public interest, with a view to restoring the confidence of investors. The architects of the IFAC reform believed these objectives could best be met by instilling greater rigor, transparency and accountability into the standard-setting process, while making the standard setting Boards operating with the support of the IFAC accountable to an independent body that ensured they served the public interest. Thus the two basic pillars upon which the reform was implemented were: • The IFAC would continue to assume responsibility for promulgating standards for auditing and assurance engagements and for the education and ethical conduct of accounting professionals. This role would be conditional on the reform of the governance, composition and operation of the IFAC standard-setting boards for these three activities. • A new body, independent of the audit profession, would be created (the PIOB), to oversee the governance and activities of each standard-setting body. The standards that emerged from this process would enhance the quality of the independent audit and improve the competence of audit practitioners. High-quality international standards developed on a collaborative basis and with a clear focus on the public interest were seen as having a greater likelihood of being accepted and implemented around the world. Under the reform program, the standard-setting boards operating with the support of the IFAC underwent sweeping changes in composition and due process, the Consultative Advisory Groups were strengthened and the IFAC enhanced its public interest agenda. The body of international standards of audit (ISAs) also underwent renovation; in February 2009, the IAASB completed the Clarity project for audit standards aimed at clarifying their intent, improving their comprehensibility, and facilitating their translation. The Code of Ethics for Professional Accountants, which includes independence requirements for auditors, also was redrafted and partially revised in June 2009.

Audit and the Current Financial Crisis

The current economic and financial crisis has highlighted the need for greater financial transparency, improved regulation of excessive risk-taking and closer supervision of the increasingly interdependent and global markets. The IFAC's newly revised standards under the Clarity project were completed just in time to play a role in this new governance of financial markets. Completed in February 2009 under the oversight of the PIOB, the Clarity project succeeded at clarifying the intent, updating and increasing the comprehensibility of the International Standards on Auditing (ISAs), paving the way for their adoption by national jurisdictions around the world. Since then the IAASB has continued to develop projects and standards, chiefly amongst which is the project on the new Auditors Report, which has involved changes to several ISAs and was approved in Decemeber 2014. The IESBA has continued to revise important sections of the Code of Ethics for Professional Accountants, its project on the auditors responsibility in dealing with non-compliance with laws and regulations (NOCLAR) deserving a special mention. And the IAESB has finalized in 2014 its review of the complete suite of education standards. Convergence among countries to an agreed set of credible international standards will contribute to the development of consistent and comparable audited financial statements and thus support the stability of the international financial system.

HOW THE PIOB OPERATES?

The PIOB is comprised of 10 members and a secretary general, who coordinates a Secretariat with a staff of 5, headquartered in Madrid. The PIOB Board meets 4 times a year at the end of each quarter: March, June, September and December. Three of the meetings are usually held in Madrid and one abroad, alternating location to achieve wider geographical presence. In addition to abiding by its internal Code of Conduct, the PIOB conducts regular self-assessments to ensure that the performance of the PIOB and its members is always responsive to any area identified for self-improvement. The PIOB's mandate is "to increase the confidence of investors and others that the public interest activities of IFAC are properly responsive to the public interest."1 This mandate originates from the agreement signed in 2003 between the International Federation of Accountants and the Monitoring Group - the 2003 Reform proposals. Effectively, this mandate implies: (i) to ensure that the processes of standard development under its oversight follow due process and are responsive to the Public interest, (ii) to ensure the completeness of the strategies and work plans of standard setting boards, (iii) to oversee the process of nominations to all PIACs and CAGs under its oversight, and (iv) to oversee the CAP. The objective of the PIOB is to protect the public interest responsiveness of the processes (standard setting, strategies, nominations, compliance) and structures (PIACs, CAGs, Nominating Committee) through its independent oversight. PIOB oversight relies mainly on direct observation by PIOB members of the PIAC, CAG, CAP and Nominating Committee meetings. PIOB members attend these meetings in person as observers to assess the public interest responsiveness of deliberations. Observations by Board members are reported to and monitored by the Secretariat, which oversees the standard setting processes. Continuity of the oversight process is assured by staff monitoring and by the quarterly convening of PIOB meetings, when the outcomes of direct observations and other issues are discussed. PIOB oversight also relies on the reports from IFAC leadership, the chairs of the PIACs, of their CAGs, and on independent staff reviews. Based on all this information, the PIOB forms an opinion on the public interest responsiveness of each stage of the processes under its oversight mandate:. a) Regarding standard setting, the PIOB mandate is to conduct due process oversight of the three sandard setting boards mentioned above with the aim of ensuring their public interest responsiveness. Public Interest responsiveness is the PIOB's primary responsibility and respect for due process helps ensure that the public interest is embedded in standard development. Oversight of the standard-setting process, including of the CAGs and the public consultation processes, helps to ensure that international standards are set in a transparent manner with sufficient attention to stakeholder input, which in turn helps to enhance their legitimacy and ensure that they area ppropriate and credible.

b) Regarding strategies and work programs, the PIOB is mandated to determine whether strategic plans are complete, in addition to considering whether due process has been followed in their development. Oversight of the strategies and work programs helps to ensure that SSB's work is focused on the needs of users of accountancy services, appropriately reflecting the public interest. The PIOB has the right to ask that particular projects be included in the plan. The PIOB also approves changes to or extensions of the strategy and work programs.

c) Regarding the process of nominations, to select candidates for SSBs, IFAC Nominating Committee and the CAP, the PIOB mandate includes overseeing the selection process managed by IFAC's Nominating Committee and approving the recommended appointments to the SSBs, including the Chairs, the IFAC Nominating Committee (excluding its two ex-officio members), and the CAP. The PIOB monitors the annual "Calls for Nominations" and makes recommendations to IFAC regarding issues such as selection criteria or definition of members' categories, and attends IFAC Nominating Committee meetings as observer through the full nominations cycle. At the end of the year, the IFAC Board submits to the PIOB for approval the list of candidates selected by IFAC's Nominating Committee to fill the vacancies in SSBs the year after. Regarding nominations to the CAGs, the PIOB oversees the CAG process to elect its Chair and approves its nomination. It also approves the nomination of new member organizations as well as the appointment of their first representatives. The PIOB oversees the five year evaluation of CAG member organizations conducted by the CAG Chair and approves any recommendations. Oversight of the nominations process helps to ensure that the persons involved in standard setting collectively bring sufficient technical competence and breadth of perspectives to develop appropriate international standards.

d) Regarding oversight of the CAP, the PIOB mandate is limited to being consulted on its strategy and work program and overseeing the due process followed in the reviews of the SMOs (Statements of Membership Obligations). In 2011, the PIOB reflected that respect for due process may not always guarantee the public interest Seventh Public Report). The public consultation carried out by the PIOB in 2012 in coordination with the MG enquired about the nature of PIOB oversight (http://www.ipiob.org/news/public-consultation-public-interest-oversight-board-work-program-2102-and-beyond). Responses suggested that oversight should be focused on protecting the public interest (PIOB Report on Consultation Process March 2013.pdf) . The PIOB agreed that increasing its oversight capacity might enhance its ability to protect the public interest and agreed that a PIOB observer or the PIOB as a whole may raise an issue of substance if the public interest is considered to be at stake. The PIOB statement following the consultation was issued in March 2013: (http://www.ipiob.org/news/piob-recommendations-response-its-consultation-piob-work-program-2012-and-beyond).

What the PIOB has done?

The PIOB has made considerable progress regarding public interest protection and independent oversight. In 2010, the Monitoring Group completed the first five-year review of the progress of the 2003 IFAC reform, which included input from the PIOB's own self-assessment report. The final MG report found that virtually all of the changes called for by the reforms had been implemented, though it acknowledged that the process of improvement is continuous (see the PIOB's Sixth Public Report, chapter four). The PIOB's self-assessment exercise concluded that the reforms implemented since 2005 had produced improvements to the governance of the IFAC and its standards-setting bodies, and to the process by which standards are set and implemented. It also underscored the degree to which the public interest had become embedded throughout the processes of standard-setting that the PIOB oversees. These improvements were achieved through the development and refinement of two of the essential elements of reform: the continuation of the IFAC's responsibility for assembling teams of highly qualified professionals to develop auditing, education and ethics standards, and the management of the potential conflict between professional and public interests through the oversight of the PIOB The PIOB has since developed and implemented several innovations directed at improving its oversight, its transparency, the perception and reality of its independence, its capacity to contribute to the public interest, and its own governance. In 2011, we reviewed our process of oversight and introduced the Oversight Assurance Methodology (OAM) through which, every year, the PIOB determines the most appropriate oversight model for each Public Interest Activity Committee (PIAC) after an assessment of risks. New oversight techniques have been added to direct observation (DO), namely remote observation (RO) and monitoring and reporting (MR). This methodology, which was implemented in 2012, is still under trial. The PIOB recently increased its oversight capacity by reallocating its resources and hiring an additional oversight adviser. It also enhanced its communications policy with a view to improving its understanding of stakeholder concerns and explaining the PIOB's role more effectively. The PIOB has increased its efforts to communicate and make transparent all of its activities: website has been enhanced to communicate its activities more effectively, especially its role, mandate, accountability, responsibilities, self assessment capacity and its perspectives on the protection of the public interest (www.ipiob.org); since 2012, the PIOB issues a quarterly update, which includes timely disclosure of meeting agendas, content of deliberations, and decisions taken, as well as past and future quarterly activities. Together with the MG and IFAC, an initiative was launched to diversify the PIOB's funding sources by contacting the main stakeholders and seeking their support. We believe that global auditing and assurance, ethics, and education standards are global public goods that deserve wider support from users, stakeholders, and international financial organizations and that the perception of independence of the PIOB will benefit from having a diversified source of funding. Despite the current difficult economic conditions, this initiative has produced promising results. In 2013, the PIOB expects that 47 percent of its budget will come from sources other than IFAC. In contributing to the public interest, the PIOB has sought over the last few years to further the debate on the need for a better governance structure and independent oversight of the International Public Sector Accounting Standards Board (IPSASB), the only standard setter supported by IFAC not currently subject to any form of independent oversight. The international financial crisis has made it clear that the current debt crisis could only have been alleviated if public accounts had been based on more appropriate, accrual-based accounting standards. International Public Sector Accounting Standards (IPSAS) are the only global public sector accounting standards based on accrual accounting that could, through wider adoption, improve global financial stability. Following the debate held in 2012 regarding how best to improve the governance structure and public interest focus of the IPSASB through independent oversight, the Monitoring Group held a roundtable in New York in February 2013 to discuss stakeholders' views and insights. After the roundtable discussion, the Monitoring Group concluded that the composition of the MG and the PIOB was not well suited for IPSASB governance. Importantly, following the 2013 Moscow statement by the G-20 finance ministers, the International Monetary Fund (IMF) and the World Bank were asked to update the G-20 on the transparency and comparability of public sector accounting, so progress is expected in this area. As part of the efforts to strengthen its governance, in February 2012 the PIOB discussed and approved its internal Code of Conduct, which applies to both PIOB members and staff. The document sets and elaborates on the principles that board and staff members are required to apply so that they conduct themselves at all times in a manner coherent with their status as members of an international organization focused on protecting the public interest. Progress has been made in the standard-setting activities of the PIACs and IFAC's Nominating Committee: in 2012, the first independent chair of the International Ethics Standards Board for Accountants (IESBA) was appointed; the International Auditing and Assurance Standards Board (IAASB) continued to improve its inclusiveness and transparency by encouraging stakeholders to actively provide input in its standard-setting activities in the public interest; the chairs of the International Accounting Education Standards Board (IAESB) and its Consultative Advisory Group (CAG) were appointed as the incumbents met their statutory time limits; and the Compliance Advisory Panel (CAP) reviewed and strengthened the Statements of Membership Obligations (SMOs) and its own terms of reference (ToR). Significant progress was also made in the nomination processes: First, IFAC reviewed the definition of non-practitioners in 2012. Secondly, the 2014 call for nominations (CFN) clearly states that nominations are open to the general public, including self-nominations, not only for public members, but also for practitioners and non-practitioners. The Nominating Committee continues to discuss PIOB suggestions, which may lead to greater diversity in the sources of nominations and greater independence of the boards from IFAC member bodies.

Where the PIOB is going?

The PIOB is reassured that the structures, processes and arrangements under its oversight have evolved into a system responsive to the public interest. The Chairs of the IAASB (since 2009) and the IESBA (since 2012) are independent from the accounting profession, the nominations to PIACs are increasingly and effectively open, and PIOB oversight processes are increasingly more refined. Increased PIOB transparency is partly the result of this confidence. Notwithstanding the need for further improvement, past progress allows us to look at the future with confidence in the quality and public interest focus of the standard-setting model built around the MG, IFAC, standard-setting boards, CAGs, and the PIOB.

One of the main concerns of the current architecture is how best to ensure the perception and reality of the independence of the standard setting boards, given that they are supported by IFAC and mainly populated by IFAC member body nominees, without affecting the high quality of the standards. The PIOB will continue to try to identify areas and suggest ideas to IFAC that might, with IFAC's full support, help to continue to advance in this direction.

The challenges in the oversight of standard setting in the fields under the PIOB mandate are expected to continue in the future, as is the PIOB's willingness to continue refining its oversight methodology and processes, performance, and transparency.The International Audit and Assurance Standards Board and the International Ethics Standards Board for Accountants have each embarked on initiatives that will promote the public interest in new and different ways and will involve a broader range of stakeholders. The Education Standards Board (IAESB) is also engaged in an ambitious cycle of revision of the eight extant education standards.

Standard setters and the PIOB will need to adapt to a widening scope of audits that goes beyond what is strictly understood today as a financial audit: The IFAC has reported that it supports initiatives led by the International Integrated Reporting Committee to create a globally accepted framework for integrated reporting, designed to bring together financial, environmental, social and governance information in a clear, concise, consistent and comparable format. But the real gain from successful standard setting comes from the application of the new standards — an objective that the IFAC works towards through the Compliance Advisory Panel. The process of adoption is complex. Large audit firms are able to adopt standards quickly through their transnational networks. However, it is the national audit authorities who have the competence to adopt standards within their jurisdiction, and this competence often does not lie with the IFAC member body. Standards also need to be translated before they can be considered for national adoption. Once adopted, the demands on the profession to ensure implementation on the field cannot be underestimated. The PIOB intends to continue to encourage, through its oversight, the entire process of adoption and implementation of standards.

2.4 Iranian Organizations in terms of Auditing and Accounting rules and principles

2.4.1 Iranian Association of Certified Public Accountants

History of Iranian Association of Certified Public Accountants (IACPA)

Audit of profit and non-profit entities, a system of professional accounting, establishment and domain of non-governmental auditing were left undecided for the first 10-15 years after the revolution. The 'Use of Specialized and Professional Services of Qualified Accountants as certified Public Accountant Act' (the Act), enacted in 1993, was a desirable response to this need. According to the Act, government may utilize the specialized and professional service of Certified Public Accountants (CPAs) as it thinks proper and fit, to monitor financial affairs of manufacturing, trading and service entities and also, to ensure the reliability of their financial statements in order to maintain investors, other interested parties and the public interests. According to sub-section 1 to the Act, the "Recognition of Qualification of Certified Public Accountants" procedural manual was ratified in 1995 by the Council of Ministers and in early 1996, Minister of Economic Affairs and Finance introduced the first group of CPAs as founders of Iranian Association of Certified Public Accountants to develop the association's Articles of Association. The Articles of Association was ratified by the Council of Ministers in September 1998. The first general assembly of CPAs was convened on August 24, 2001, to elect High Council members. High Council members were duly elected by direct vote of CPA members and the Association was duly established.

Strategy and Objectives of IACPA

Iranian Association of Certified Public Accountants (IACPA) is regulating and promoting accounting and auditing profession in the country and oversight of the work of members by:

Organizing CPAs.

Enhancement and development of professional services through preparation, compilation, publication and promotion of accounting, financial services and ethics standards;

Enhancement of professional knowledge of certified public accountants through development and improvement of training, research and issuance of specialized and professional publications;

Safeguarding the professional interests of members.

Communication with regional and international professional bodies and becoming a member thereof with the goal of advancement of professional connections.

Committees

The Association's oversight over its members is through its Specialized Committees under relevant governing bodies' supervision. Board of Directors proposed members for specialized committees are approved by High Council as to their competency. Specialized committees function is to review, express an opinion and report to relevant governing bodies. Specialized committees opinions are expressed based on IACPA Act and Regulations and are of advisory nature. To better deal with specialized duties, IACPA has formed the following committees consisting experienced CPAs:

Quality Control Committee

A five-member standing committee with overseeing member firms and sole-practitioners performance and compliance with auditing standards and Code of Ethics as its main responsibilities.

Technical and Standards committee

A five-member standing committee with research in accounting and auditing standards, propose required new or modifications to existing, standards to Audit Organization– the Iranian standard setter- and develop professional guidelines as its main functions.

Laws and Regulations committee

A five-member standing committee basically responsible for review of financial laws and regulations in order to recommend suggestions to regulatory bodies for development of new, or modifications to existing, laws and regulations; garner relevant laws and regulations and its distribution proposal.

Tax Committee

A five-member standing committee essentially for reviewing tax laws and regulations to present suggestions to the authorities; developing tax manuals and guidelines for application by IACPA members; and providing solutions for certain tax issues raised by members.

Code of Ethics Committee

A five-member standing committee responsible mainly for development of IACPA Code of Ethics and suggestions to better it; and reviewing and providing opinions as to members' queries, claims and complaints regarding ethical issues.

Member Firms Committee

A five-member standing committee with development of rules and regulations for establishment and administration of public accounting firms; oversight of member firms compliance with IACPA regulation; review application for new firms as to its conformity with IACPA regulations; and suggestion of membership fees as main functions.

Governing Bodies

The governing bodies of IACPA are as follows:

High Council

High Council comprises 11 experienced and expert CPAs elected from within the members by the members for a three year term. One delegate appointed by the Minister of Economic Affairs and Finance, one by the Stock Exchange Council, and one by the High Council of Banks also attend the meeting without voting right. High Council is the highest governing body, and is responsible for matters such as setting the strategy and approval of plans, manuals, annual budget, financial statements of IACPA, appointment of the board of directors and disciplinary board members. Approval of specialized committee members competency, determining entry fees and performance of professional oversight through specialized committees are part of High Council duties.

Board of Directors

Board of Directors comprises 3 or 5 CPAs selected from within the members and appointed by the president for three years. The High Council appoints one of the members of the board as Chief Executive Officer and Secretary General who will handle the Association's affairs on a full –time basis. Implementation of High Council directives; planning; organizing; preparation of manuals, annual budget, financial statements and execution of plans are among the duties of Secretary General and the Board. Each member of the board is responsible for part of the activities of the Association. Other duties of the board include establishing specialized committees; recommending entry, fixed and variable membership fees; and preparation of directives necessary for execution of duties.

Supreme Oversight Board

Supreme Oversight Board comprises one chief and two members, all CPAs, appointed from within the members of the Association by the Minister of Economic Affairs and Finance for a tow year term. The Board has the duties of examining and expressing an opinion on the fairness of information reported by the Board of Directors, annual financial statements of IACPA, performance of the Association and its members, and also to render regular reports of its activities to the Minister of Economic Affairs and finance, High Council and the Board of Directors as necessary.

Members

The number of members of the Certified Public Accountants, quoted from IACPA's official website is about 1850 and more than 200 audit firms are working in Iran.

2.4.2 Audit Organization of Iran

History

After the victory of the Islamic Revolution in 1979, according to the laws and regulations adopted by the Revolutionary Council, numerous nonprofit and profit-making and non-profit institutions and organizations were either governed by government. For auditing of such institutions, three audit institutions in the public sector of Iran called the National Audit Office of the National Organization of Industrialists and Planners, the Audit Institute of the Mostazafan Foundation (1981) and the Shahed Audit Institute (1984) each of them was responsible for statutory audits and audits of a group of companies and institutions. In 1983, according to the law passed by the Islamic Consultative Assembly, it was established by the merger of these three institutes and the audit company (which was formed in 1972 and was audited by state-owned companies). The statute of the Audit Organization was approved by the Islamic Consultative Assembly in 1983, and thus the Audit Organization was formed as an institution with legal personality and financial independence and affiliated with the Ministry of Economic Affairs and Finance, which, while continuing to fulfill the duties of the said institutions, to operate in other areas specified in Statute itself.

The subjects of the organization

• Providing the state's basic requirements for auditing and providing specialized financial services to government and government-controlled sectors.

• Compilation and generalization of accounting and auditing principles and rules and the practice of professional conduct in accordance with Islamic standards.

• Research and development in scientific and practical methods in order to enhance specialized knowledge adapted to the needs of the country.

The most important tasks of the organization

Audit and legal inspection Audit and inspection of companies with 100 percent of their capital owned by the government, ministries, institutions and state-owned enterprises.

• Audit and legal inspection of companies that account for more than 50 percent of their capital Owned by state-owned enterprises or state-owned enterprises, determined by the Ministry of Economic Affairs and Finance.

• The statutory audits and inspections of the Islamic Revolutionary Institutions, if approved by the Assembly or their highest pillar, and other facilities run by the elected government of the State.

• The statutory audits and inspections of the subsidiaries of banks, non-governmental institutions and institutions of the Islamic Revolutionary Organization and other facilities operated by the elected government of the government, if approved by their General Assembly.

• The auditing of fixed asset holdings and other fixed asset formation contracts (such as reciprocity) executed in the devices of paragraphs first and second above.

• Operational audits of those companies and capital asset management plans under the authority of an organization that have an important, sensitive or high volume of operations are referenced by the Minister of Economic Affairs and Finance. In addition to the above, the organization can conduct operational audits of companies that are optional for operational auditing, tailored to the capacity and facilities available.

• Other references by the Minister of Economic Affairs and Finance.

• Audit and legal inspection of other devices in terms of facilities and execution plans.

Financial Services consulting

Providing financial and managerial services and advice to the ministries, government agencies and institutions referred to above.

• Providing financial advisory services, and designing and deploying financial systems and management services to other devices.

Legislation of accounting and auditing principles.

Establishment and publication of accounting and auditing principles by consulting the Iranian Society of Certified Accountants and other competent authorities. The principles and rules of professional practice include: accounting standards, auditing standards, and professional ethics guidelines for dealing with these issues.

• Formulating the ethical standards and professional conduct of the organization's auditors on the basis of Islamic principles.

Research and Publishing instruction

Perform research and studies to obtain the latest information on accounting and auditing and other related disciplines.

• Publishing and disseminating the results of studies and research in order to continuously increase the level of specialized knowledge of accounting and auditing in the country.

• Cooperation with government organizations, universities, training centers and other devices in the field of human resources preparation for accounting and auditing purposes.

• Training and training of committed people to provide the required expert staff through the implementation of continuing education programs for employees in the organization.

2.4.3 Tehran Stock Exchange (TSE)

History

TSE opened in February 1967. During its first year of activity, only six companies were listed in TSE. Then Government bonds and certain State-baked certificate were traded in the market. The Tehran Stock Exchange has come a long way. Today TSE has evolved into an exciting and growing marketplace where individual and institutional investor trade securities of over 325 listed companies, 38 Industries, 11 ETFs, 175 mutual funds, 105 brokerage firms, 9 investment banks, 12 portfolio managers, 14 investment advisories. TSE activities process could be divided into three periods:

Since the beginning of TSE activity until revolution (1967-1978)

In the period of 1967 to 1978 the number of listed companies and their capital raised from 6 with IRRs 6.2 b to 105 (22 private banks, 2 insurance companies, and 81 industrial corporations) with IRRs 240 b. In 1967 the value of shares and bonds traded in the TSE, was IR 15 m, which increased to IRRs 34.2 b in 1978. Actually, most of this development activity was due to the ratification of ownership development of manufacturing units' stocks and tax exemption for the listed companies' laws.

Since revolution until the end of imposed war: (1979-1988)

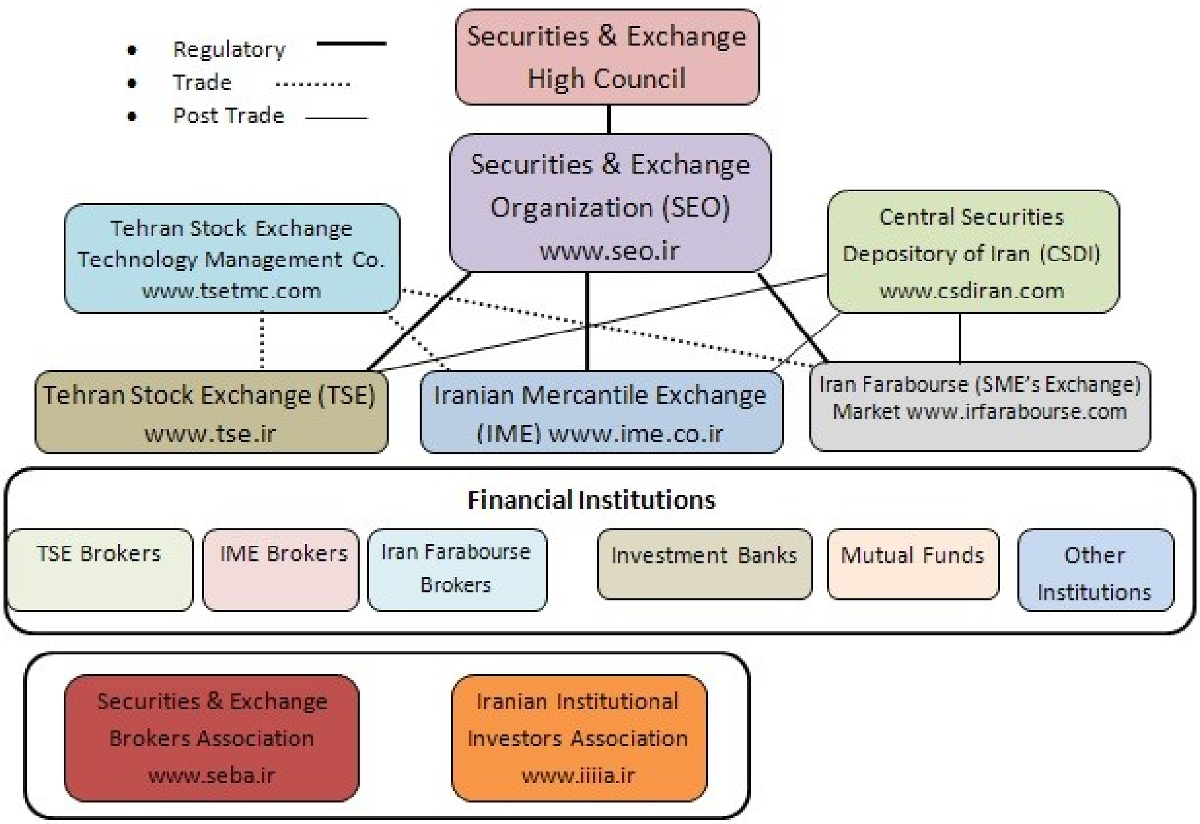
In the second period of TSE activities, two important events i.e. the Islamic revolution and Iraq's invasion were reduced exchange activities severely and exiting number of listed companies from TSE. In 1978 the value of shares traded was reduced to IRRs 4.1 b and this trend continued to 1982 and reached IRRs 9 m. From 1982 the trend of shares value increased and finally at the end of the period reached IRRs 9.9 b.

Since the end of the imposed war until now (1989-now)

In fact, TSE was taken into account as one of the most important executive mechanisms for national economy optimization in order to facilitate the equipment and active contribution of the private sector in the productive activities through transferring some of the state duties to the private sector, gathering and errant savings, all to be directed toward investment. In 1989, economic authorities' attention to restarting of TSE activities increased the number of listed companies from 56 in 1988 to 422 in 2006. Furthermore, in 1988 the annual value of shares traded in the TSE, was IRRs 9.9 b, which increased to IRRs 44.8 b in 2006. During this period, especially between 2001 -2004, return of TSE investments grown up considerably and in 2003 reached to 131.4% which on that year was the highest return between WFE's members. In 2005, the market was restructured and demutualized. Therefore, the authority body was separated from the executive body. TSE launched its first derivatives which was single stock futures in 2010. Meanwhile, it started the online trading system which played a key role in speeding up trading. In 2016, TSE upgraded the market infrastructures, extended the debt market and inaugurated option market. TSE was self-listed simultaneously. In the last year, the Exchange offered the first IPO through book building mechanism. Membership in International Organizations

- World Federation of Exchanges (WFE): Joined in 1992.
- Federation of Euro- Asian Stock Exchanges (FEAS): Joined in 1995.
- ICGN: Joined in 2008
- OIC Member States' Stock Exchanges Forum: Joined in 2008

Legal structure



TSE overriding goal is to provide reliable facilities for the efficient and orderly conduct of trading securities. It is also entrusted to regulate the activities of brokers and safeguard the interests of the investing public through ongoing trading floor and broker supervision and overall market surveillance. TSE is supervised by a seven-member Board of Directors that sets strategy and operating policy. These individuals, elected for a term of two years by shareholders' general assembly appoint a Managing Director. The job of the Managing Director is to manage the operations of the Exchange through various department heads who report to him. Managing Director's term of office is for a two-year renewable term.

Roles of TSE

Legislation establishing Tehran Stock Exchange (TSE) was formally enacted in 1966 and TSE began operation on April 6, 1967. Forty years after the establishment of the TSE, a new Securities Act was passed in November 2005. Under this Act, TSE have been demutualized.

As defined in the Article of Association, TSE's primary roles are: • Establishing, organizing and managing of the Stock Exchange in order to trade listed securities

• Listing of securities

• Prescribing membership requirements for members and supervising their performance, and regulating their activities

• overseeing the transactions of the Exchange listed securities

• Monitoring the performance of issuers of the listed securities

• Processing and disseminating the information regarding the securities orders and transactions of securities

Capital and Shareholders

The capital stock of the Company is equal to the sum of 900 billion Rials, which is divided into 900 million registered common shares of 1000 Rials each. Shareholders of the Company shall be classified as follows:

• Class one: Persons who have received the license for brokerage activities in compliance with the Stock Exchange Establishment Law [1966] or those who shall receive the license for broker/dealer activities in compliance with the Securities Act [2005] and shall be accepted as the members of the TSE.

• Class two: Financial institutions other than brokerage firms who shall receive the activity license from the SEO.

• Class three: All persons other than class one or two above.

The maximum percentage of shares belonging to each class of shareholders defined above will be determined by the SEO. At the moment no individual shareholder of any class can hold more than 2.5 percent of the Exchange's total number of shares.

TSE Future Outlook

• Increasing the number of listed companies, improving market liquidity

- Enhancing TSE brand and promoting the transparency as the company's image
- Further development of technology infrastructures to enhance market surveillance
- Developing financial knowledge and improving investment and shareholding culture in Iran by educational programs and use of mass media to reduce investment risks and increase transparency
- Developing channels of knowledge-sharing with other exchanges
- Derivatives market expansion by introducing new options contracts
- Introducing new kinds of ETFs
- Introducing new kinds of project funds
- Increasing the volume of floating stocks
- Expansion of debt securities by introducing Islamic treasury bills and participation certificates

Mission

Launching a fair, efficient and transparent market equipped with diversified instruments and easy access to create added value for the stakeholders.

Vision

The region's leading Exchange and country's economic growth drive.

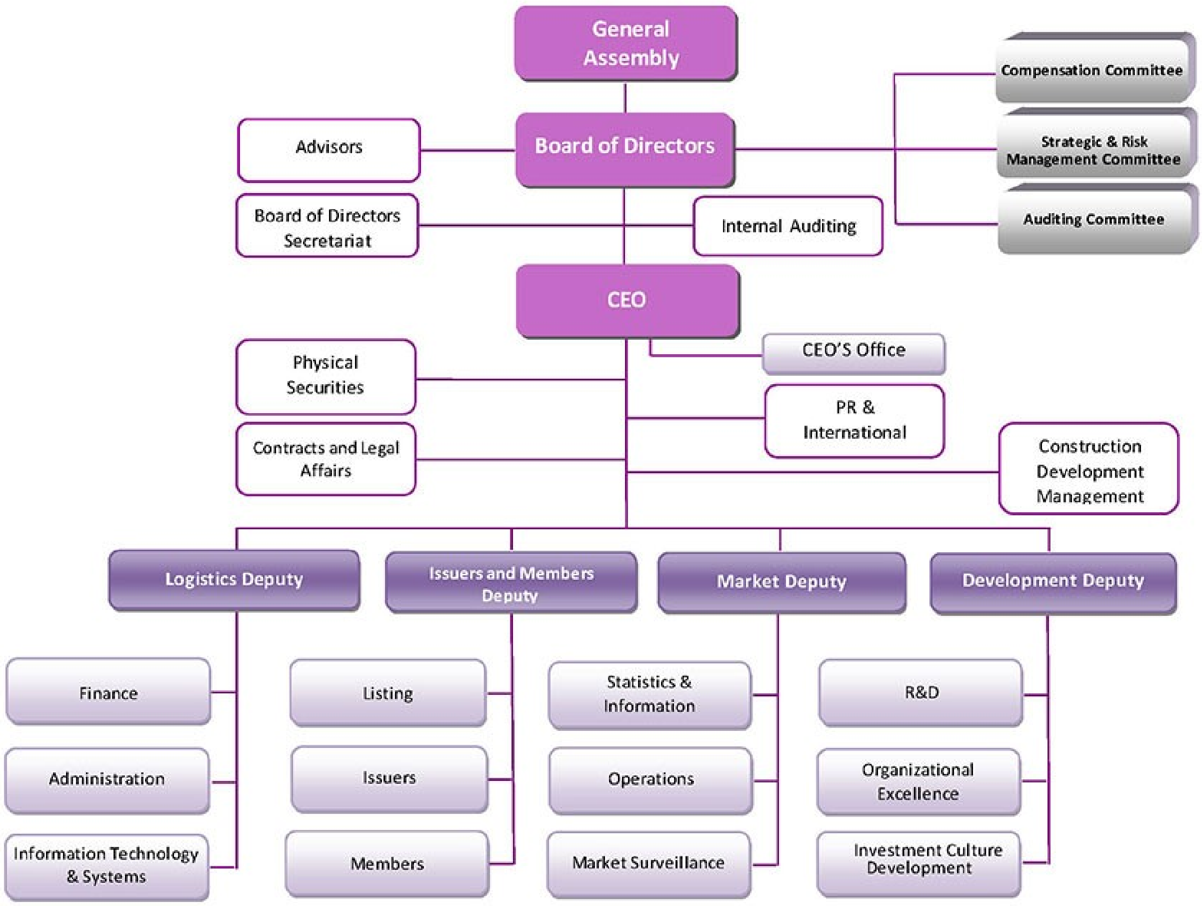
Goals

- Increasing the share of capital market in financing the economic productive activities
- Applying effective rules and procedures to protect the market's integrity and shareholders' rights
- Expanding market with the use of updated and efficient technology and processes
- Developing financial knowledge and improving investment and shareholding culture in Iran
- Facilitating market access by means of information technology

- Observing accountability and transparency in cooperation with the stakeholders
- Constant expansion of the company's intellectual properties and human resources

Chart of organization

of org.jpg



Chapter 3

Research Methodology

3.1 Research type

Based on theoretical foundations, the type of research after the research purpose is exploratory, it seeks to discover the elements of a pattern and to explain the causal relationship between components of a pattern. In terms of research, research is both quantitative and qualitative. That means not only the data should be collected quantitatively from qualified persons (partners and managers of audit firms), but also data quality analysis should be performed. Since the establishment an oversight organization independent of the audit profession has long been going on in many countries of the world, and the positive outcomes of this institution on the audit profession and, finally, the impact of these results on the quality of carrying out audit projects have been revealed. In recent years, the necessity of establishing of an oversight organization has been recognized by many of the great and reputable professors of the accounting and auditing profession in Iran. This research is the first international study to establish or not establish an oversight organization independent of audit profession in comparison with the laws governing Europe. The result of the experience of the international community (such as the United States, Britain, Italy, China, Germany, France, etc.) has been gathered in an international body called International Forum of Independent Audit Regulators (IFIAR), and the result is the principles that this assembly has defined for independent auditors. These principles are investigated in three parts of the structure, operations, and principles of inspection and in 11 principles, this research is questionnaire-based, and 23 questions were asked based on the above mentioned principles, which included 83 senior executives of the audit organization, managers of the Iranian Association of Certified Public Accountants, partners and managers of more than 10 major audit institutions in Iran, completed the questionnaires. In the following, a summary of the eleven principles and brief conclusions from the research will be mentioned:

3.1.1 Structure:

Principle 1: The responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation. Audit regulators should have a mandate to work in the public interest and protect investors by seeking to improve audit quality. The responsibilities and powers of audit regulators should, at a minimum, require independent oversight of the audits of public interest entities. The legal framework for audit oversight should set forth the audit regulator's mandate and responsibilities, and provide the regulator with adequate powers and authority that enable the regulator to perform its audit oversight duties, including powers to address, through inspection and enforcement, compliance with the requirements for the authorization/registration of auditors/audit firms and compliance with applicable auditing, professional and independence standards.

Principle 2: Audit regulators should be operationally independent. Independence means the ability to undertake regulatory activity and to take and enforce decisions without external interference by those regulated. The audit regulator should be operationally independent from external political interference and from commercial, or other sectorial interests, in the exercise of its functions and powers, including not being controlled in its governance by audit practitioners. The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.

Principle 3: Audit regulators should be transparent and accountable. The audit regulator should have public accountability in the use of its powers and resources to ensure that the audit regulator maintains its integrity and credibility. Further, the decisions and actions of the audit regulator should be subject to appropriate scrutiny and review, including appeal to a higher authority. Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm by firm basis.

This section describes the structure and fundamental principles necessary for the establishment of the oversight organization and the existence and realization of these principles is essential and crucial for the establishment of the oversight organization because:

• If the responsibilities and authorities of the audit regulators are not clear and these responsibilities and authorities are not clearly expressed to serve the public interest, owners of capital and investors cannot trust the audit regulators properly, so the results of their work are not accepted by the community.

• If audit regulators are not operationally independent, the influence of institutions, organizations and other people such as professionals in the profession or tycoons will affect their work, and this effect will distort the desired outcome and thus will not be reliable for over sighting.

• If audit regulators are not accountable to the public, if there is a mistake in using their authority and resources, there is no higher organization or institution to appeal to the public and it's not possible for people to appeal.

Five questions were asked about this section, most respondents agree that:

• The audit regulators' responsibilities and authorities are to serve the public interest.

- An audit regulator should be independent of the profession.
- An institution that is the organizer of a certified public accountant test (this institution is responsible for monitoring the quality control of audit firms) cannot be run by members who are themselves the owners of audit firms.
- Given the need for transparency and accountability of audit regulators, this transparency and accountability has been confirmed by most respondents.
- Most respondents oppose the government to take over this organization.

3.1.2 The operation:

Principle 4: Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit license and/or registration. Audit regulators should at a minimum be responsible for the system and conduct of recurring inspection of audit firms undertaking audits of public interest entities. Audit regulators should have the authority and ability to enforce inspection findings and recommendations. The audit regulator should have comprehensive enforcement arrangements such as fines, suspensions and the removal of an auditor's or audit firm's license or registration. Audit regulators should have adequate and appropriate mechanisms for enabling information to be brought to their attention by third parties and for then dealing with such information, such as through complaints procedures or through whistle blowing arrangements. These mechanisms should act in a timely and effective manner and their results followed up through an appropriate system of investigations and penalties in relation to cases of inadequate or non compliant execution of an audit.

Principle 5: Audit regulators should ensure that their staff is independent from the profession and should have sufficient staff of appropriate competence. Audit regulators should have arrangements in place to ensure that inspection staff members are independent of the profession. These arrangements will, as a minimum, include ensuring that staff members should not be practicing auditors or employed by or affiliated with an audit firm, and that the arrangements are not controlled in any form by a professional body. In order for audit regulators to be effective, it is a prerequisite that there is sufficient staff of appropriate competence. The persons carrying out the reviews of quality assurance systems of audit firms should have appropriate professional training and relevant experience in auditing and financial reporting, and training in regulatory quality assurance reviews. This also means that adequate arrangements for consultation and discussion amongst inspectors are in place. New inspectors should be subject to proper supervision and appropriate training.

Principle 6: Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements. Audit regulators should maintain the highest standards of ethical conduct to provide the public with confidence in the objectivity of their decisions. Audit regulators should have in place prohibitions against conflicts of interest by its governing body and staff and ensure that appropriate arrangements are in place to protect confidential information from public dissemination.

Principle 7: Audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties. Taking into account the global nature of the financial markets, where necessary and relevant, cooperation and information sharing with other audit regulators and other third parties, including financial market regulators, is helpful to improve audit quality.
Audit regulators should provide timely assistance to each other within reasonable limits. Arrangements should be in place for sharing information between audit regulators and other regulators (or between parts of the audit oversight system if it involves more than one body), and for protecting the confidentiality of such information.

The existence and realization of this sector for the implementation of audit oversight is very necessary. If any of the above principles are absent, monitoring of the work of the audit firms and quality control of the audit firms is not feasible because each of the following components is required for correct and proper monitoring.

In connection with this section, four questions were asked from respondents, most of them agree that:

- Cash imposition is necessary as disciplinary action for audit firms.
- The revocation of the license of the audit firm's activity is necessary as a disciplinary action.
- The issuance of a license activity of an audit firm is required by an organization which is independent of the audit profession.
- Monitoring of the securities stock exchange organization is required on audit firms.

3.1.3 Principles for inspections:

Principle 8: Audit regulators should as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations. The recurring inspections should be conducted pursuant to a process comprising the selection of the audit firms to inspect, appointment of an inspection teams with appropriate expertise and competence, notification to the audit firm, advance documentation request, notification of selection of audit engagements for review, meetings with management, and on-site inspection arrangements. The inspection process should be subject to appropriate internal quality control within the audit regulator to ensure high quality and consistency.

Principle 9: Audit regulators should ensure that a risk-based inspections program is in place. Audit regulators should have a process for assessing risks in the audit environment and audit risks in individual regulated firms and their audit engagements. Audit regulators should have a process for taking into account their risk assessment in allocating their inspection resources and in the inspection approaches they adopt. These processes should be commensurate with the size and complexity of the audit firms and their clients. Audit regulators should have an established minimum cycle regarding the frequency of inspections.

Principle 10: Audit regulators should ensure that inspections include effective procedures for both firm wide and file reviews. The risk-based inspection approach should also be reflected in both firm wide and audit file inspection procedures. The firm wide procedures should address the audit firm's quality control system as reflected in the firm's organization, policies and procedures. ISQC 1 or similar standards should be used as a benchmark in performing firm wide procedures. The inspection process should also include adequate testing of selected audit files in order both to determine the effectiveness of the firm's quality control system and to assess compliance with applicable laws, rules and professional standards.

Principle 11: Audit regulators should have a mechanism for reporting inspections findings to the audit firm and ensuring remediation of findings with the audit firm. Audit regulators should have a process that ensures that criticisms or potential defects in an audit firm's quality control systems and issues related to an audit firm's performance of audits that are identified during an inspection are reported to the audit firm. Audit regulators' reporting processes should include the preparation and issuance of a draft inspection report, a process for the audit firm to respond, and the preparation and issuance of a final inspection report. In addition, audit regulators should have a process for ensuring that audit firms satisfactorily address inspection findings that were reported to the audit firm by the audit regulator.

This section is after the structural and operational sections. After defining the structure of the oversight organization and its components and defining the elements and principles of the operations section, the principles of inspection determine the principles that influence the effectiveness of the oversight that outlines the type and procedure of oversight.

The necessity and realization of each of the principles mentioned in the principles of inspection is very important and effective because:

• Lack of assess professional standards and independence requirements and other laws will continuously and periodically create a vacuum of inspection and evaluation that will lead to deviations from the standards and appropriate audit of some of the audit firms.

• Lack of risk assessment in the audit environment, at the level of the audit firms and at the level of audit projects, makes the inspection approach isn't selected and the resources of the inspection are not properly allocated.

• If inspections do not include effective methods at the level of the audit firms and at the level of the audit files, the quality of inspection of the audit regulators will be reduced and, as a result, supervision is not in the public interest.

• The lack of corrective actions by the audit firms after reporting the findings to the audit firms cause to not getting a proper results from the inspections and, as a result, all inspections will remain ineffective.

In connection with the inspection department, 11 questions were asked, which the opinion of most respondents is:

• Annual monitoring or periodic monitoring is necessary.

• The process of selecting audit firms, announcing to audit firm partners, requesting documentation, and conducting inspections are not effectively performed by audit regulators.

• Inspections from audit firms are not carried out based on risk-based audits.

• The risk assessment process at the level of the audit firms and at the level of audit projects is not carried out by audit regulators.

- The risk assessment process does not take into account the size and complexity of the audit firms and their clients.
- Inspections of audit regulators do not include effective methods of inspection at the audit firms' level and at the level of audit files.
- Risk-based approach to inspection methods, both at the level of audit firms and at the level of audit files, is not implemented by regulators.
- Most respondents agree that the methods used by regulators at the level of the audit firms are influencing the quality control system of the audit firms.
- The process of inspection of audit files by audit regulators ensures compliance with the rules and regulations of professional standards.
- After completing the inspection process, the audit regulators cannot ensure that corrective actions are taken by the audit firms.
- There are no proper monitoring methods to follow up corrective actions, and audit regulators have not designed and implemented this process.

In the fourth part of the questionnaire, three questions were asked from respondents. According to this survey, the answers of most people are summarized as follows:

- Establishing an oversight organization independent of profession can reduce the threats to the independence of auditors.
- An oversight organization independent of profession should be established to improve the quality of audit projects and maintain the independence of auditors.
- How to fund the cited organization is a combination of funding from the government, receive a percentage of the income of the audit firms, receive a percentage of the income of the Tehran Stock Exchange.

After obtaining the result, the result of the research is applied. That is, with the consent of the majority of respondents, an oversight organization independent of profession can be established that the quality of its management is proposed and implemented through a survey of qualified individuals and organizations.

3.2 Research Method

Given the nature of the research and the kind of research mentioned above, the type of research is a questionnaire selected by the researcher based on the assumptions mentioned by a population. This population should include competent respondents. After selecting the population, the researcher asks questions that, after collecting responses from respondents, they achieve a general conclusion and the researcher, based on his findings, can prove the hypotheses presented. Finally, the result of the research is obtained by analyzing the answers of the respondents.

3.3 Population

To carry out a research, if the factors affecting the research variables are more limited, the research variables will be more capable of control, and the study of these variables will yield more accurate and more scientific results. In order to obtain the desired result in this research, qualified professionals were chosen who, given their professional knowledge, as well as the ongoing professional work of the audit, by them, their answers to the researcher's conclusion Research is very important.

3.3.1 Qualified people

It is said that after gaining sufficient and necessary knowledge in the field of accounting and auditing at the university, taking into account the work in the audit profession, he has the necessary experience in this field and has the necessary and sufficient information on accounting and auditing standards. And also their knowledge in these fields is up to date. Examples of qualified people are presented below:

Managers and Partners of Audit firms:

Under the laws of the Iranian Association of Certified Public Accountants, people who are employed as directors and partners in audit firms must have work experience at least 3 years of full-time in an audit firm or 6-year full-time work experience in accounting and finance field, and after passing a test held by the Ministry of Economic Affairs and Finance, they are selected as Certified Public Accountant, and after 6 years of professional activity, they can act as a Director or Partner. Consequently, these people, according to their experience and professional knowledge, give more accurate and relevant answers to the questionnaire and can help to achieve a more favorable outcome in this research.

Managers of the Audit Organization of Iran

Individuals who work for the Audit Organization of Iran as audit directors have generally followed the rankings of the assistant auditor, the auditor, the senior auditor, audit supervisor, the senior audit supervisor, and now they are working as an Audit Director. Most of these people are considered to be the appropriate people for research, considering that they have an important role in developing the accounting and auditing standards of Iran.

Managers of the Iranian Association of Certified Public Accountants:

Managers of the Iranian Association of Certified Public Accountants (directors of committee in the Iranian Association of Certified Public Accountants) generally work at different audit firms, and some of them are partners in audit firms and given the fact that these people play a significant role in legislating on accounting and auditing professions and drafting directives, They can help with the completion of the questionnaires and the results of the research, and with their professional opinions on each of the questions of the questionnaire can help improve the quality of research as well as obtaining the views of those who work in the macro level of the profession Work will provide more favorable outcomes for the research objectives.

3.4 Data Collection Method

3.4.1 Subject category:

In Explanation 1-3, the eleven principles required for the establishing an oversight organization independent of the profession are described.The questions asked to gain insight into the audit system and its operation and the quality of audits carried out in Iran. After sufficient knowledge of the weaknesses in the audit process and the weaknesses in the audit firms, respondents in the profession will decide on how to establish an oversight organization independent of the profession, given the weaknesses. Hence, the researcher will question the above principles and will answer the questionnaire by completing the questionnaire and collecting it from the respondents.

3.4.2 Relationships between Population and Data Collection:

In Iran, audiences interested in audit profession after undergraduate academic studies in accounting, auditing and management at the undergraduate level are recruited to audit firms and after 3 years of professional audit they are qualified to participate in the Certified Public Accountant exam, and after succession of the cited exam can be worked as a director at an audit firm. The years of experience of these people in the audit profession make them well acquainted with the weaknesses of the audit system in Iran and, given their knowledge and professional qualifications, they can be considered as the appropriate population for this research. Based on the audit of many companies from different industries in Iran, these people are familiar with the weaknesses of the audit system and the weaknesses in the supervision of audit firms by the audit regulators, and they, according to their experience and knowledge, completed the questionnaires. Also, the managers of audit organization of Iran and managers of the Iranian Association of Certified Public Accountants are aware of their job position on the weaknesses of the audit system and the manner in which auditing in Iran and the weaknesses of supervision of audit firms, and according to their experience in this matter and completed the questionnaire can help the researcher, in order to make a more appropriate, more conciliatory, and more realistic of the audit weaknesses in Iran, and thus determine whether or not to establish an organization independent of the profession.

3.5 Research credibility

3.5.1 Internal credit:

In the research, The questions raised here are as follows:

- Are the content and questions raised to achieve the result?

- Have questions and content provided the correct image of the audit profession in Iran?

3.5.2 External credit:

Below are some examples of questions: • Are the people who answer the questions, their answers are based on sufficient knowledge and experience?

- Do respondents have sufficient control over the Iranian auditing environment?

- Can the answers of the population help to achieve the research goal?

3.6 Obstacles and Research Restrictions

3.6.1 Difficult access to Population:

Since the audit directors and partners of the audit firms are very busy and generally do not have enough time to answer the questionnaires, and since the population of this research was only audit directors and partners of the audit firms and audit directors of Audit Organization of Iran and the managers of Iranian Association of Certified Public Accountants, One of the biggest limitations of this study was to make an appointment with these people and complete the questionnaire by them.

3.6.2 Failure to fill questionnaires by the population:

According to the meeting with partners, the audit directors of the audit firms, the directors of audit organization of Iran and the directors of the Iranian Association of Certified Public Accountants, questionnaires were given to them, but due to numerous follow-ups, some of them did not complete the questionnaires.

3.6.3 The peak of the work of audit firms

In Iran, due to the fact that the majority of companies' financial statements date at the end of the solar year (March 20th), due to tax reasons and the deadline for shareholder's meeting, the first four months of each year are the peak of the work of the audit firms. During these four months, the audit firms do not specify any time to schedule appointments with the directors and partners of the audit firms.

Chapter 4

Analytical approaches

In each research, after designing the research hypotheses and investigating the research, and developing the appropriate research method to test each hypothesis, it is time to analyze the data according to the specified methods. If we want to define data analysis, it is a process whereby the data collected from the research sample is tested in a meaningful and principled manner. And then, after confirmation, the accuracy of the test will be interpreted. So it can be said that this step is the most important step in the process of doing a research, because the effects of the first (defining research hypotheses), second (investigating research literature) and third (defining research methods) are determined at this stage. And on the other hand, this step (analytical approaches) has an impact on the next step, the conclusion of the research. So the most critical part of any research is the data analysis section. In this chapter, the researcher, after examining the questionnaire and the answers given, determines the test results. As mentioned in Chapter 3, questions were raised regarding the Eleven Principles, which include questions and answers of the respondents.

4.1 Population

83 respondents filled questionnaires which consisted of 23 questions among this population where mostly working for several audit firms, managers of Iranian Association of Certified Public Accountants and managers of Audit organization of Iran and based in Tehran. 8 percent of respondents were in management occupations and 20 percent of them were partners in their firms.

4.2 Answers

The first question was: "in your opinion is the audit regulators' responsibilities and authorities serve to the public interest?" 92.8% of respondents believed that the audit regulators' responsibilities and authorities serve to the public interest while 7.2% dissented from this view. A comments made by one of Those who dissented from this view is as follows: "As being attention to the public interest is the premise of CPA' society's professional code of conduct, This matter should be supported and guaranteed by authorities and responsibilities of these professional.

The second question was: "should audit regulators be independent of the professional community?" Majority of the respondents (85.5%) agreed with this statements; however, 14.5% of them is disagreed. Here is a comment made by one of the advocates of this practice to strengthen the efficacy of these issues respite representative from different industries could be invited to attend the councils.

The third question was; "in your vantage point can the members of an entity that hold CPA Examination, themselves own the audit firms?" Almost four out of five of the respondents disagree to the statement while only fifth of them agreed. This a comment made by one of the respondents: "It's like a double edged sword; close supervision on the examination to make sure they are held in a correct and standard way is it necessary.

The fourth question is: “given the need for the independence of the monitoring unit on the audit firms, in your opinion, is it not better if a governmental organization is in charge of overseeing?” 59% of those who responded disagreed with this point of view, and only 41% found this idea acceptable. There are two comments put by respondents who disagreed: “The government itself is a beneficiary which has power, so this practice is not appropriate.” “The cited organization should be independent of all organs in general, and since in Iran, unlike industrialized countries, there is no basis for the existence of such an organization in the Government, then oversight organization should be exercised by elected members of the Judicial system, the parliament and the government responsible for the leadership and directing this organization, and if the government alone cares for the management of this organization, it will be inspected itself and this dependence on the government will eliminate the independence of the oversight organization.”

The fifth question was: “given that the oversight the audit firms should be transparent and that regulators should be responsible for their monitoring, do you endorse this oversight? More than four out of five among the respondents were proponents of such oversight while less than fifth of them tended to dissent.

The sixth question is: “Do you agree with the necessity of the monitoring of audit firms by the stock exchange organization?” 62.7% of the respondents answered this question with a Yes, but the others (37.3%) disagreed. This is a comment made by one of the opponents of this view: “Absolutely not. The regulations made by Audit Organization of Iran (AOI) had better be issued with the assistance of the Iranian Association Certified Public Accountants.

The seventh question was: “in your opinion, is the imposition of cash penalties necessary as a disciplinary action for the audit firms?” 77.1% of the respondents concurred with this view whereas 22.9% of them dissented. According to the respondents, as the credit of such audit firms is their most value of their property, they definitely strive to keep it; however, some other penalties should be considered to enhance the effectively of this method.

Eighth question was: "in your vantage point, is revoking audit firm's license of activity required as a disciplinary action?" More than 90% of the respondents agree with implementation of such a punishment, while 7.2% disagreed with it. Here are some comments made by some of the respondents: "In some cases it is necessary". "As revoking the license of activity of two partners at such audit firms leads to the revocation of the firm's license of activity, this punishment should be considered if necessary.

The ninth question was: "in your opinion, is an annual oversight or ongoing periodic monitoring necessary?" 91.6% believed it is necessary while the other disagreed. Here are two comments from the respondents: "I agree but not a necessarily an annual for each firm. Based on the firm's records, this oversight could be reduced." "I believe the annual oversight is enough but not the way it is conducted currently."

The tenth question was: "do you think that the issue of the licenses e of activity of audit firms should be done by an organization independent of profession?" 62.7% agreed and 37.3% tended to disagree.

The eleventh question was: "is the process of selecting audit firms, announcing to audit firm's partners, requesting documentation, and conducting inspection are in practice effectively carried out by audit regulators?" 61.4% of them are disagree and the other tended to agree. Here is the comments made by one of the respondents: "No choice is made by the inspectors but inspection are carried out."

The twelfth question was: "in your vantage point, is inspection of audit firms performed risk-based?" 83.1% disagreed and only 16.9% tended to agree.

The thirteenth question was: "In your opinion, is the risk assessment process at the level of the audit firms and at the level of audit projects is performed by the audit regulators?" Almost three out of four respondents dissented whereas fourth of them only concurred with this view.

The fourteenth question was: "are these processes performed with regard to the size and complexity of the audit firms and their clients?" 67.5% disagreed and 32.5% tended to agree. The fifteenth question was: "Do the audit regulators Inspections include effective investigative methods at the level of audit firms and at the level of audit files? 53% disagreed and 47% tended to agree.

The sixteenth question was: "In your opinion, is risk-based approach in the inspection methods implemented booth at the level of the audit firms and at the level of the audit files by the audit regulators?" Almost three out of four respondents disagreed and the other tended to agree.

The seventeenth question was:" Do you agree that the applied methods by the audit regulators are effective on the quality control system at the level of audit firms?" 79% of respondents agreed with this view and the other tended to disagree.

The eighteenth question was: "does the audit files inspection process by audit regulators ensure that the rules and regulations of professional standards have been observed?" 79.5% of the respondents agreed and the other tended to dissent.

The nineteenth question was:" in your opinion, can audit regulators make sure that after the inspection process audit firms make corrective measures?" The respondents were almost equally divided on this matter. Here is a comment from one of the respondents: "It is important and the flaws should be re-examinated next time inspection is performed."

The twentieth question was:" in your vantage point, are the suitable monitoring methods for following these actions and do audit regulators design and implement these processes?" 69.9% of respondents disagree and the other agreed.

The twenty first question was: "in your opinion, can establishing an oversight organization independent of the profession reduce the factors that threaten the independence of the auditors?" 69.9% of the respondents agree and the other tended to disagree.

The twenty second question was: "Regarding the above questions, do you agree that an oversight organization should be established to improve the quality of the audit projects and maintain the independence of the auditors?" More than four out of five respondents concurred with this view whereas less than fifth of them dissented.

The twenty third question was: "Which of the following methods do it endorse for funding the oversight organization in order to maintain its independence?" 22.9% believed funding by the government is the most appropriate choice .9.6%, however, thought the oversight organization should get a percentage of income of the audit firm.4.8% of the respondents believe that the oversight organization should get a percentage of the stock market revenues. A striking 61.4% believed the oversight organization should get its financial resources from all of them mentioned sources. Here is a comment from one of the respondents: "Between these options maybe "Funding by the government" could be less harmlful for the independence of the over-sight body but is not the best way. I think various elements should be considered to decide about this matter.

4.3 Comparison of the answers with European regulations

For majority of questions respondents agreed with the European regulations. For questions 4 and 23 the division is observed between the respondents answers and EU regulations. Based on the answers the majority of the respondents agree with the establishment of an oversight organization independent of profession while some disagreement is seen among them about its funding and efficacy.

Chapter 5

Conclusion

A brief overview of the research seasons is provided below to familiarize you with the research and to arrive at a better conclusion. In the first chapter of the research, a thesis article was presented to familiarize the audience with the research topic, as well as research hypotheses. In the research literature, which is the second chapter of the research, the first section describes the factors affecting the independence of auditors such as client importance, non-audit services, auditor tenure, and client's affiliation with audit firms. The next section discusses:

Does Non-Audit Service Affect Auditors' Independence?

The next part in part two is about public interest oversight board:

- what about PIOB?
- What has he done?
- what is its purpose?

Is being investigated. In the final part of the second chapter of the research to familiarize ourselves with the auditing environment in Iran, we introduce the influential organizations and policy makers in the field of auditing and accounting standards such as Audit Organization of Iran, Iranian Association of Certified Public Accountants and the Iranian Stock Exchange.

The research methodology is described in detail in Chapter Three. This section describes the type of research, research methodology, and statistical population. In the type of research section, the Eleven Principles are outlined and the questions in the questionnaire are presented in each of the following sections: Structure, operations and inspection principles are discussed separately and the views of the individuals are described and the results of the questions are described in general. Also in this section, the limiting factors of the research, the reasons for selecting the statistical population and the validity of the research are considered.

In the fourth chapter, which is called the analytical approach, the questions in the questionnaire are presented along with the overall results of each question and the comments of the respondents and this analysis leads to the conclusion in the fifth chapter.

In this research, we tried to ask questions that represent the auditing environment in Iran and the experts who have important responsibilities in the auditing profession in Iran were asked to fill out a questionnaire which was based on their professional experience and knowledge. Appropriate coverage of the research subject. The above-mentioned principles are respected in most countries of the world, especially in European countries, and since these principles are generally not respected in Iran, a questionnaire was developed based on each of the principles, opinions of experts and professionals working in the profession. Auditors in Iran are asked that the differences and discrepancies of these principles and laws tested in Europe with respect to Iran be removed.

According to the answers provided, most respondents agreed to establish an organization independent of the auditing profession, but disagreed on how to run the organization, which summarized their views as follows:

Some believe that the government should be in charge of the organization, they see the government as a guarantor of the implementation of its obligations and laws.

Another group believes that the government alone is corrupt and because this organization is an oversight organization and the results of its activity directly and indirectly affect the country's economy and ultimately the decisions of individuals and legal entities, Therefore, it should be run by individuals representing the Government (governmental organization such as Audit Organization of Iran), Parliament, Judiciary and the IACPA so that no group or power can interfere with the proper functioning of the organization.

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[111] TSE: Tehran Stock Exchange, *http://www.tse.ir/en*

[112] POIB: Poblic Interest Oversight Board *http://www.ipiob.org/*

[113] OUDIT, *https://audit.org.ir/*