

AUDITOR PERSPECTIVES ON CONFIDENTIALITY: A QUALITATIVE INVESTIGATION EXAMINING THE DIFFERENCES IN EUROPEAN AUDITORS' OPINIONS

Donald F. Arnold, Sr.

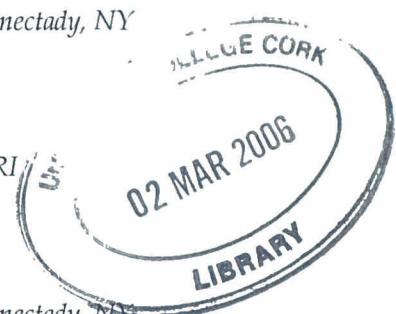
The Graduate College of Union University, Schenectady, NY

Richard A. Bernardi

Roger Williams University, Bristol, RI

Presha E. Neidermeyer

The Graduate College of Union University, Schenectady, NY



ABSTRACT

This exploratory research examines the existence of variations in the application of the principle of auditor confidentiality within a western European setting. A case study method was used employing a series of open ended questions to isolate participants' views on the importance of and factors influencing the practice of keeping client information confidential. The interviews yielded substantially different views on the application of the principle of confidentiality when placed in the context of a dilemma situation. Participants were partners and managers from four large international accounting firms located in eight western European countries (Denmark, France, Ireland, Italy, Spain, Sweden, the Netherlands and the United Kingdom). The findings imply that, although similar codes regarding confidentiality exist, in practice there may be substantial variations in western European auditors' interpretations of the codes, resulting in potential audit opinion variations despite similar factual situations. Understanding this type of variation is critical to stakeholders in the international financial communities who rely on auditors to attest to the accuracy of the financial statements for decision making purposes.

INTRODUCTION

In order to complete a successful audit, auditors must have access to proprietary business information given to them by the client's management. The client will only be willing to provide this information with the assurance that it will not be

revealed. This principle of confidentiality is guaranteed by the various national codes of conduct to which auditors ascribe. However, due to the existence of various stakeholder groups in the financial communities who rely upon the audit (e.g. current and potential investors and creditors), an auditor may be faced with situations in which responsibilities to some of these groups are in conflict, creating a challenging situation for adhering to the confidentiality principle.

The current exploratory research uses a dilemma based case study with open ended interview questions to document perceptions regarding confidentiality based auditor decisions of 69 auditor partners and managers from eight western European countries. The perceptions sought focused on their decision regarding disclosure of confidential client information and important factors that might influence such a decision.

LITERATURE REVIEW

Although confidentiality is critically important to such other professions as medicine and law, in no other profession are the lines of allegiance to the various stakeholders so multi-faceted. Medicine has the Hippocratic Oath (Edelstein, 1943) and the legal profession has the principle of attorney-client privilege. Within the legal profession, this principle suggests that an attorney cannot be compelled to offer testimony or divulge information that was given by a client in confidence (Wigmore, 1961). Since there are others within the legal process to protect and serve the needs of the public (e.g. prosecutors, juries, judges and the entire judicial appellate system), the legal system works well with this construct.

For financial reporting to achieve its primary goal of usefulness to the stakeholder, the auditor must have access to all client files, financial records and other pertinent information. From the perspective of management, the auditor must maintain a high level of confidentiality with regard to these records and information since their public disclosure could have significant business effects on their client's firm. Without auditor confidentiality, the client would be hesitant to reveal information relevant to the auditor. Section 4 of the International Federation of Accountants' Code of Ethics for Professional Accountants (1999) suggests that confidentiality of information is required and that accountants have an

obligation to respect the confidentiality of information about a client's or employer's affairs acquired in the course of professional services. The duty of confidentiality continues even after the end of the relationship between the professional accountant and the client or employer.

However, in contrast to the lawyer's position, the responsibility of the auditor is not only toward the management but also toward the stockholders and the investing public in general who rely upon the accuracy of the financial statements when making their investment decisions. While the legal system draws upon multiple parties noted above to represent the different stakeholders, the auditor generally is the sole individual to whom the multiple stakeholders (e.g. current and prospective investors and creditors) look in determining the fairness of the

publicly reported financial information. Accordingly, when the auditors make decisions, such as those applying to confidentiality, they might feel compelled to take into consideration the effect that such decisions will have on more than simply the company who hired them to do the audit.

Empirical work studying the implementation and interpretation of the rules on confidentiality is almost non-existent. Rowan (1987) conducted a very informal study of Canadian accountants, where he presented a dilemma regarding the use of confidential information discovered in one audit that applies to the appropriate audit opinion that should be issued for a second client. After noting that the rules on confidentiality appear clear, he goes on to question:

What is a firm to do when information obtained in confidence from one client is material to the audit of another? ... If they neither disclose or use the information ... [they will] be signing a false and misleading opinion if they give an unqualified opinion on [client A's] financial statements ... To those problems there is no clear answer and, so far, little clarification to be gleaned from legal decisions. (p. 50)

[He] spoke to a number of members of the profession about this and got a variety of responses. On one point there was agreement: no one knows what the right answer is. Moreover, many doubt there is a right answer. (p. 50)

The only other empirical study we found was that of Adams, Malone and James (1995) who examined the limitations placed on the rule of confidentiality by using dilemmas where auditors became aware of confidential information gained on an audit. One of the dilemmas used was that of an auditor who had a client seeking a large loan where the prospective lender does not know the company is in a seriously weakened financial position. When asked by the researcher about the proper course of action (given the requirement of confidentiality), 78 per cent of the auditors indicated that they would *not* disclose the information. The implication was that they would follow the 'rule deontology' code whereby 'an accountant is morally bound to act according to the requirement of a rule of conduct of the Code without regard to a concern for the effects of that action.' (Adams et al., p. 1017) When queried about the best ethical course of action (independent of the code) only 53 per cent believed the most ethical behaviour, from a utilitarian principle (i.e. following the action that would produce the greatest amount of good for the greatest number of people), would be not to disclose the confidential information in the bank loan case. The difference between those two figures would indicate that the principle of confidentiality, though based on a concept that would appear to benefit society, might at times (78 per cent versus 53 per cent) lead to action that does not provide the greatest good to the greatest number of people.

RESEARCH OBJECTIVES

Similar to the scenario in Adams et al. (1995), the auditor in our scenario, when conducting the audit of a first client, becomes knowledgeable about facts concerning a second client's ability to remain a going concern. Within the current research, the first client demands that this information not be revealed.

We extended the research of both Rowan (1987) and Adams et al. (1995) by focusing in on (a) western European auditors and (b) between-region differences in auditors' decisions. The first research objective was to see if there was divergence in the application of the rule of confidentiality within a western European audience of auditors. The second research objective was to see if there were similarities within but divergence between different geographical regions in western Europe as to how the principle of auditor independence was applied. In addition, by utilising open ended questions in a personal interview format, we were able to gain a more in depth understanding of related actions that the auditors would take.

Research Objective 1: Determine if there is divergence in responses among auditors within western Europe

When formulating the first research objective, we asked why we might anticipate finding differences in the application of the rule of confidentiality among auditors from different western European countries. In order to guarantee that the results of this research were not driven simply by differences in the rules of confidentiality in the various countries involved, we began by obtaining and reviewing the applicable rules within the countries included in this study. While the specific words used in expressing provision for confidentiality varied between countries, the consensus of the 'professional right and duty of confidentiality' (Lauder, 2004) was consistently and uniformly applied. Characteristics common to all of the rules on confidentiality included:

1. Keeping confidential that information which was discovered in the course of professional duties,
2. Allowing disclosure only if consent is granted by the client or if required by law or duty (public duty), and
3. Not using the information for personal gain or the gain of others.

The Italian rule states (and others imply) that disclosure is also allowed to protect the auditor's professional interest in case of a legal proceeding. The rules of the Irish and England and Wales bodies also go on to state that 'when a member has confidential information which affects an assurance report...he cannot provide an opinion which he already knows, from whatever source, to be untrue' (2003). The results of our examination of the rules from the other countries appear to indicate, however, that they are silent on this particular issue. For a more detailed presentation of quotations from the rules on confidentiality, see **Appendix 1**.

It is clear that the principle of auditor confidentiality is consistently required through the eight countries included in this research¹. Accordingly, we proceeded with confidence that any differences found were not driven by country differences in the professional rules of confidentiality.

But if there were no code or rule differences, what might lead us to anticipate differences in the application of the rules on confidentiality between countries or regions? Prior research on professional conduct of auditors, including their application of the rule of auditor independence and auditors' selection of materiality cutoffs (Arnold, Bernardi and Neidermeyer, 1999; Arnold, Bernardi and Neidermeyer, 2001), indicates the existence of country-specific differences. It seems only logical that such research be extended into the realm of the rule of auditor confidentiality. This prior research further indicated that the unique culture of the countries involved plays a role in the application of these auditing principles and rules. Therefore, it might well be expected that between country differences in the application of the rule of confidentiality might also exist.

Research Objective 2: Determine if there are similarities within and divergence between regions of western Europe.

Our research interest also extended to the possibility of regionally based trends in the application of the principle of independence. Accordingly, we established as our second research objective that of extending the analysis by grouping the population into three regional groups of northern Europe (Denmark, Sweden and the Netherlands) – hereafter NE, southern Europe (Italy, Spain and France) – hereafter SE – and the UK and Ireland – hereafter UK/I. This grouping is consistent with Nobes' (1983) classification of accounting systems (Ireland and the United Kingdom being 'micro-based, business practice, pragmatic', Spain France and Italy being 'macro-uniform, continental: government, tax and legal' based and Sweden being 'macro-uniform, government and economics' based). Furthermore, prior research on the application of auditing principles (Arnold et al., 1999; Arnold et al., 2001) found association between country differences and the cultural constructs developed by Hofstede (2001). When plotting each of Hofstede's four cultural construct index scores in a comparative 2x2 matrix with a quadrant-split at a score of 54 (the approximate mid-way point on his scale), we see that for all six combinations of constructs, taken two at a time, the grouping of Sweden, Denmark and the Netherlands fell into one quadrant. The same was true for the grouping of the UK and Ireland. A combination of the Nobes and Hofstede findings indicate that the groupings made for this analysis find support in both an accounting systems base and a cultural construct base.

The focus of this research was limited to western European auditors for two reasons. First, the prior research noted above, which provides justification for our research, was limited to European auditors. Second, with the increased cooperation among the western European countries, through the European Union, it seems appropriate to limit the subject base to this single community.

METHOD

Participants

A semi-structured, face-to-face, interview was conducted individually with each of 69 auditors (25 partners and 44 managers) of four international accounting firms in eight different western European countries. Individuals who had spent more than one year as expatriates were removed from the analysis. To generate this sample population, the authors contacted large international auditing firms in nine European countries². See **Table 1** for demographic information.

TABLE I: PARTICIPANTS

Country		Region		Firm		Level		Gender	
Denmark	11	Northern Europe	25	#1	13	Partner	25	Male	58
UK	9	Southern Europe	28	#2	18	Manager	44	Female	11
France	4	UK/I	16	#3	11				
Ireland	7			#4	27				
Italy	14								
Netherlands	7								
Spain	10								
Sweden	7								
Total	69		69		69		69		69

The interviews contained one case with nine open ended pre-formulated questions, though, when appropriate, some topics were probed in more depth with additional questions. See **Appendix 2** for the complete scenario given as well as the questions asked of the subjects. The goal was to gather information about participants' beliefs as to the outcomes in the case, particularly referencing the auditing rules regarding confidentiality of client information. Each subject was privately and individually interviewed for approximately 20 minutes.

All interviews were conducted at the firms' offices and were audio tape-recorded, for later transcription, with the consent of the participants. The cases were provided to the interviewees a few days prior to the interviews so that they might consider the issues. Each subject was instructed not to discuss the case with anyone prior to the interview. The individual subjects were selected by the representative within the firm who served as contact person with the lead author. All conversations were in English since participants were proficient in the language (such proficiency was determined prior to the interview taking place by inquiry of the individual accounting firms). For consistency, all interviews were conducted by the lead author. The participants were given numeric code names for the purposes of transcription and analysis.

Case Content

The key elements of the case used in this study include the fact that the audit firm provides service to two clients. The first of these clients (Client A) is a service provider to the second (Client B) and is currently financially dependent upon the business from B. The auditor has learned in the course of B's audit that Client B will not be renewing the service contract with Client A, with the imminent outcome that Client A will not be able to continue its operations successfully. Client B will not agree to publicly revealing this fact, however, until after Client A's final audit opinion is issued, and no other additional audit procedures on Client A will reveal it. The implication to the auditor is that Client A is no longer a going concern but the knowledge of this condition only comes from information confidentially received from Client B; thus issuing a going concern opinion for Client A would be tantamount to revealing confidential information.

The case also notes that Client A is a major employer in a financially depressed town and is attempting to get a loan from the local bank. If the loan is granted and then defaulted on, there would be serious ramifications to the bank and its community.

Central to the case is the fact that simple and strict compliance with the rule of confidentiality will have an impact on the audit opinion expressed on another client which, in turn, could have a major impact on a group of outside stakeholders (including the bank and the community). The case was designed to place the subjects in a dilemma with ethical implications when deciding how to apply the rule of confidentiality. See **Appendix 2** for the entire case and follow-up questions asked³.

Analysis

Due to the stream of data present in a transcript, the data were analysed by searching each interview for unique bits of data worthy of attention. Each type of response was coded and assigned to a broader category representing themes of answers.

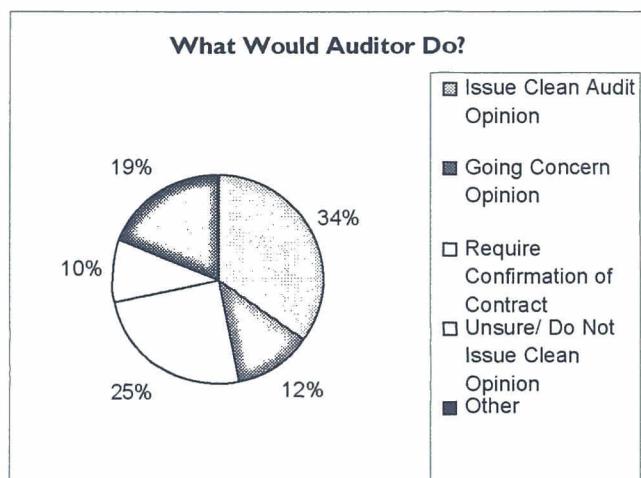
Within each case, the authors usually established two *a priori* coding categories -the auditor believed that the behaviour either would or would not take place (i.e., that individual auditors would either engage or not engage in a particular behaviour or activity). Within those categories, we developed sub-codes as they emerged from the transcripts and modified the initial supposition if required. When included in the paper, the quotations may have been slightly edited for readability.

An examination of the transcriptions indicated that there were no significant differences in responses by managers as compared to partners. Accordingly, further distinction by staff level was not made. In addition, we did not attempt to analyse any hesitation or facial expressions by the subjects when they provided responses. Since many of them spoke English only as a second language, it would have been difficult, if not impossible, to distinguish whether these factors were caused by concerns regarding their responses as opposed to one of searching for the proper English words when expressing their thoughts and responses.

DISCUSSION ⁴

In response to the first question and substantiated by the last question asked (i.e. "What would you do in this case?"), 34 per cent of the auditors queried responded that they would issue a clean opinion, with the majority, however, requiring that this audit opinion would include a clear statement of the risk to client A of having such a large portion of its business being based on one client. This type of opinion draws attention to this risk, irrespective of the pending contract cancellation. Twenty-five per cent indicated that they would insist that client A seek out and provide confirmation of the continuation of the contract with client B – which the auditor knew would not be granted by B – and when this was not obtained then issue an appropriate audit opinion. Twelve per cent indicated that they would issue a going concern opinion (i.e. revealing confidential information) while 10 per cent noted that they would not sign a clean opinion, but they were not sure what they would do. The remaining 19 per cent were split between those resigning from the audit, those issuing another type of opinion (e.g. "no opinion") and those simply never answering the question. The overall responses are displayed in Figure 1.

Figure 1: Question 1 & 2



Interviewees who favoured the clean opinion based their answers primarily on the concept of full adherence to the principle of confidentiality and often made reference to the concept of creating Chinese walls in their mind as they do the two audits. (Note: See **Appendix 3** for a description of the code system used to identify the source of each quote.)

I would issue a clean audit opinion. I can split my brain and set up a Chinese wall and not think about the information garnered in the course of one audit in issuing the audit opinion of another. So long as they provide adequate disclosure and you

do not know the information directly from B, you would have to issue a clean opinion. (614321)

My feeling is that anything we find out performing one audit – that is privileged information which cannot be used for another audit. We cannot even discuss it. Information we get from performing the audit of B – I am not allowed to use that information in any other way. (811122)

As the auditor of A, I have no knowledge that it is going to go bankrupt. As the auditor of B I do have knowledge. But in that respect I am two persons. I am definitely not one person. I cannot find the information and I cannot break that promise (of confidentiality) to B. As long as it is indicated in the financials (that) this company is heavily dependent upon one customer, I think that I would sign that clean opinion. (111111)

We are like a priest who receives a confession, there is nothing we can do. (321512)

Unfortunately you have this information but can do nothing with it because of the issue of confidentiality from an ethical perspective of what our institute here tells us. It is absolute. So you know, but you cannot divulge; it is absolute, regardless of the human behaviour response. (432221)

When you have a piece of confidential information it is almost the same if you don't have that piece of information. So you have to behave as if you did not have it. (432221)

Opponents of issuing the clean opinion gave a variety of reasons including refusing to put up the Chinese walls, protecting the financial community and potential legal ramifications once the information does become public.

This information is part of my audit evidence. And once I see it then there is no other way I should react except by giving a going concern opinion, even though I got it through confidential information. Any kind of news you come to know about your client, even though confidential, is part of the audit evidence. If Company B now starts to spread bad rumours about our firm disclosing private information – well that is part of the risk that an audit firm has to accept. (523422)

When we do an audit, we are protecting the reader, the financial community and the general community. So the answer will be very easy. I have to disclaim my opinion. (523111)

We will get sued by issuing a clean opinion. And their lawyer would say, "Did I know that the contract would not be renewed?" and I would have to say "Yes". Irrespective of how I obtained that information we would lose the lawsuit. Therefore, I would have to give a going concern opinion. (434322)

I believe in this circumstance I would not abide by Company B's request to refrain from discussing the confidential information. I think that if you give a clean opinion to Company A knowing that the contract will be broken down by B, the responsibility to the key users of Company A's financial statements would be

substantial. And if I must choose between two faults I would choose breach of confidentiality. (321211)

First, I would try to get Company A to get representations from B. If B would not give such a confirmation I would give a non-going concern opinion to A. (321311)

I would sign a going concern opinion because they are going to be bankrupt. I know that B will say I revealed confidential information, that is a good point. But the problem is they have to sign the opinion that way because A is really going to be in bankruptcy. In my case, I could never put the Chinese Walls in my mind and say, "I've got that information but should not have had it therefore I am going to ignore it." Why? Because I have it. (722121).

If they do not give me written documentation of the contract, I would issue a going concern paragraph. (722321)

It is my responsibility to issue a going concern modification in the audit report of B (722421)

There is no way I can ignore the information I got from B. There is no way I can issue a clean audit opinion. (724522)

Require contract confirmation otherwise give going concern. (432322 & 434221)

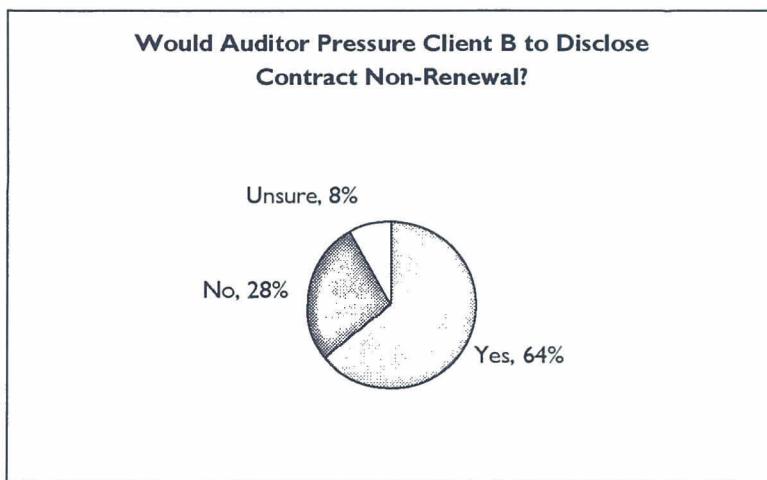
When broken down by general geographic areas of NE, SE, and UK/I, for purposes of analysing research objective 2, considerable differences were noted. As seen in **Table 2**, there was a strong propensity in NE (68 per cent) to ignore the information obtained from client B and issue a clean opinion (with the risk factor stated) whereas the comparable numbers for SE and UK/I were only 18 per cent and 13 per cent respectively. The only auditors who indicated that they would reveal the confidential information by issuing a going concern opinion were in SE, where 29 per cent of the interviewees gave this response, while only 18 per cent were willing to give the clean opinion.

The UK/I auditors had a tendency to look for some other solution, with 44 per cent (compared to eight per cent in NE and 29 per cent in SE) using the technique of requiring confirmation of the contract and acting accordingly when such confirmation was not obtained and 38 per cent (compared to eight per cent in NE and 19 per cent in SE) either responding "would not sign clean opinion, but not sure what to do" or simply never answering the question.

TABLE 2: AUDIT OPINION TO BE ISSUED

TYPE OF OPINION ISSUED	Northern	Southern	UK/I	Total
	Europe %	Europe %	%	%
"Clean" Opinion (usually with paragraph referring to high risk)	68	18	13	35
"Going Concern" Opinion	0	29	0	12
Required confirmation of contract. If not obtained, then issue appropriate Opinion	8	29	44	25
Do not sign clean opinion but not sure what to do	8	7	19	10
Other responses				
Never answered question	0	11	19	9
Other Opinions (e.g. "no opinion")	4	4	0	3
Resign from audit	12	4	6	7
TOTAL	100	100	100	100

As can be seen in **Figure 2**, many (but not all) auditors felt that it would be appropriate and that they would attempt to exert some pressure on Client B to disclose the non-renewal of the contract prior to Client A's audit opinion date (Question 3). This allows the auditor to issue the appropriate going concern opinion without revealing confidential information gained from Client A.

Figure 2: Question 3

Those favouring placing pressure on Client B to reveal their intention to cancel the contract made statements such as:

I would try to convince them. I would try to use more commercial reasons that they ought to inform their supplier of doing so. I would not base it on the fact that A will go bankrupt and I am trying to audit A. (114121)

That would be the first thing you would try to do. But if it does not lead anywhere, you are in a strange situation. (814621)

Others stated that they would not attempt to make B disclose:

No, clearly it depends upon the personal relationship that you have with the management of client B; my first reaction would be that it is the audit firm's problem. Thus a good approach would not include putting pressure on our client as a result of our firm's audit problem. (521511)

It would be difficult if you are going to continue having Client B as an audit client. If they get the feeling that you are considering the effect of their actions on other companies and you are not considering them totally independently it could then turn off your credibility with them making it difficult to do the audit in future years. (232521)

When examining the replies for research objective 2, the results show a strong consistency in responses to this question by the interviewees from the three different geographical regions.

Question 4 (i.e. suggesting to the bank that there might be underlying reasons not to make the loan while not suggesting what they were) provided a potential way of protecting the bank's interests without revealing the confidential information. The implication of this question was that by encouraging the bank to reject the loan application from Client A, the impact of not revealing the confidential information would be greatly diminished.

As **Figure 3** shows, fifty per cent of the individuals questioned did not think that they should participate in such a discussion while 41 per cent thought this was an acceptable solution and nine per cent were unsure.

Some responses from those suggesting a "heavy" suggestion to the bank that they know the risk of the loan included:

I would express several times that it a risky loan and they know that themselves. (113621)

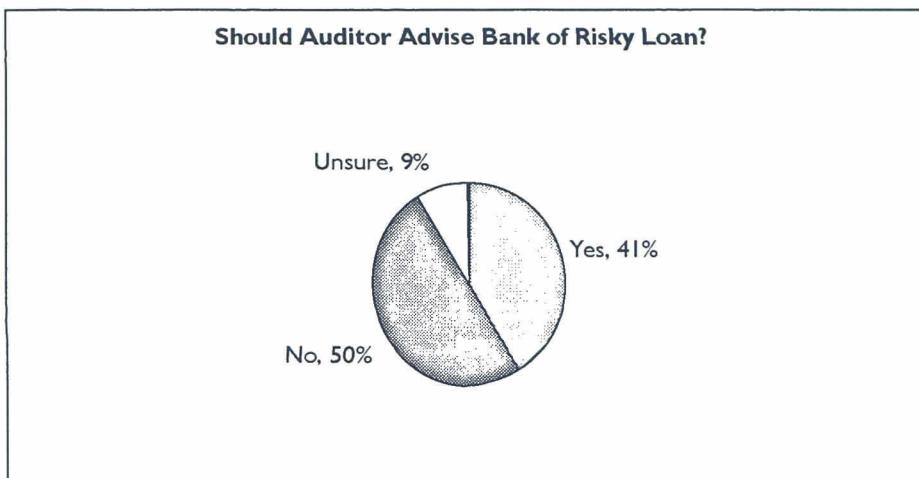
Since A has very little chance of success at the end of the day, perhaps you should go to the bank and say you will have a problem if you make this loan. (612521)

Of those who suggested not telling the bank, the responses included:

If I overplay the role, the question would immediately be, "Why are you saying that in that way? Do you know something that we do not know?" And in answering, "I cannot answer that question," in theory you have told them about it. (111211)

No – it would be against the ethical rules. (814121)

Figure 3: Question 4



There were some regional differences (research objective 2) on this issue. Fifty-six per cent of the NE auditors provided an answer of either "yes" or "maybe" whereas only 24 per cent from the SE and UK/I countries agreed. One might hypothesise that the high response percentage by the NE auditors was an offset to their tendency not to disclose the confidential information.

Figures 4 and 5 show that when asked whether the audit firm should resign from the audit of either Client A or B (Questions 5 and 6), the responses were largely (and consistently across regions) in favour of not resigning from either audit (77 per cent said do not resign from Client A and 73 per cent said do not resign from Client B). Many individuals suggested that this merely pushes the problem onto another auditor or audit firm and if one were to resign, the reason would have to be stated, thus not solving the problem.

I would not even consider withdrawing because that would be a break of confidence to both parties, since I would not be able to give an explanation. I would say that withdrawing is definitely forbidden. (111111)

Resigning would be unprofessional. (114221)

That is quite a cowardly thing to do, if you are the auditor there. (814422)

I would not consider it because you cannot say why you are walking away. (814521)

I would not even consider resigning from Client B. That would not help me; I still have the information problem. (614221)

Figure 4: Question 5

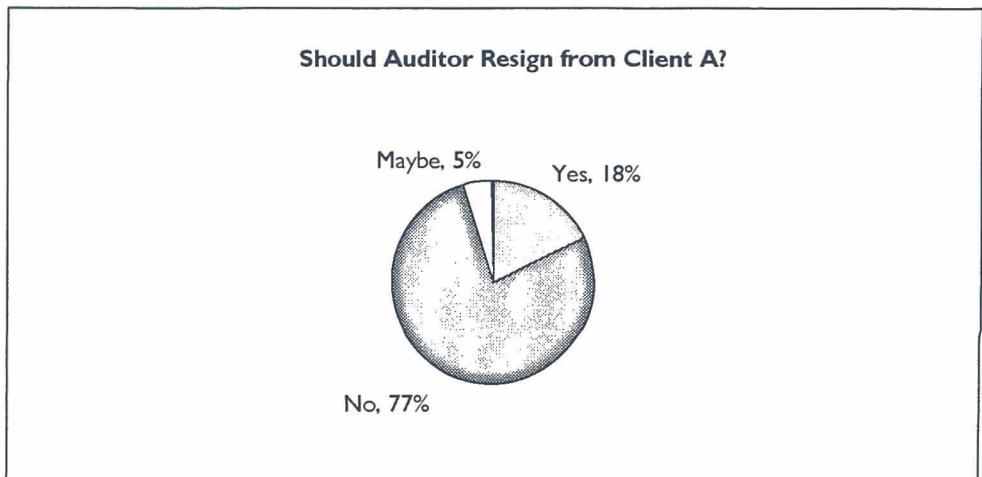
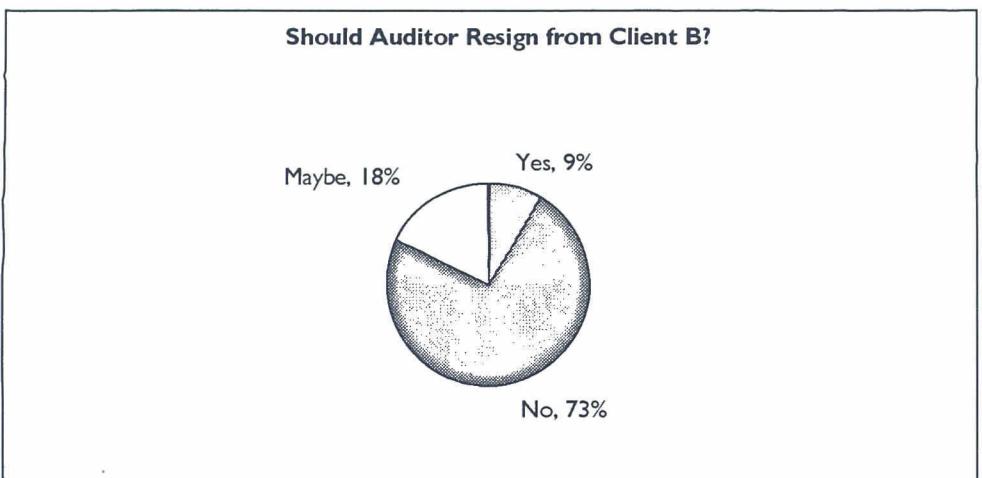


Figure 5: Question 6



While problems might develop when the new auditors ask the reason for resigning, a minority of the subjects said they would resign.

I think that if this situation has so many risks I would probably decide to resign but first of all I would evaluate the two kinds of risks. The first risk is that of a wrong auditor report while the second one is to have the business community know that our firm spreads confidential information. If the first is too high, I would resign from A. If the second is too high I would also resign from B. (521112)

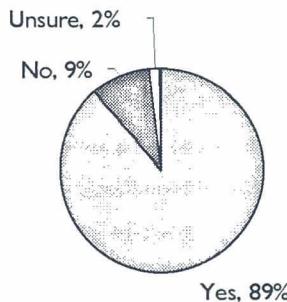
If you did decide to walk away - which one would you walk away from? If you leave client A, what are you going to say to the new auditors that come along when they ask you if there is any reasons why they should not accept the appointment as the new auditors. This is reasonable. I think that I would say that I have a conflict of interest and resign. (232421)

You would have to choose which was your best client and resign. I think that B is your best client, but I guess I still would have the problem when you resign from an audit you must give a statement that there are no problems and you must give the reason for resigning. (234521)

The vast majority of auditors (89 per cent) believe that the firm can audit both clients (**Figure 6**). Only nine per cent responded that this was inappropriate and two per cent did not answer the question. Thirty two per cent of those responding that the firm could audit both clients did suggest that separate audit partners be assigned to handle the engagements. Nine per cent of those answering in the affirmative suggested that Chinese walls be erected to keep information separate and two per cent suggested that this be discussed with both clients prior to making a decision. These responses were consistent across geographical areas.

Figure 6: Question 7

Can Firm Audit Both Clients?



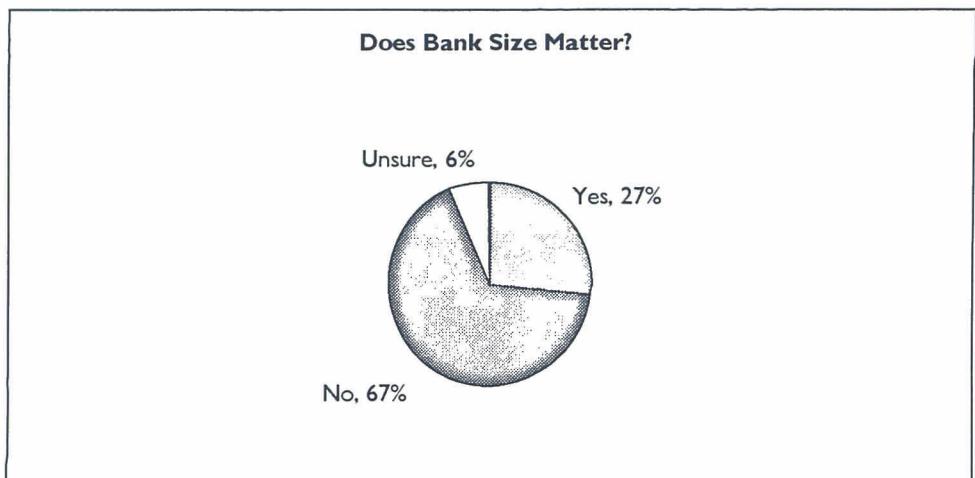
We would consider putting different partners on the different engagements building up Chinese walls within the firm. (113211)

It would be better to assign it to another partner within the firm but I would not consider having the firm leave one of the two clients. (113411)

The implication of Question 8 (Does the bank size influence your decision?) was to determine if the auditors' decisions regarding non-disclosure might be a function of the relative impact of the consequences that would be suffered by the bank if they relied on the "incorrect" audit report (see **Figure 7**). The bank size did

not matter to the majority of auditors, 67 per cent stating that the size of the bank would not influence their decision to disclose or not disclose the non-renewal of the contract. Twenty-seven per cent stated that the bank size was important and that they were more likely to disclose the non-renewal to a *smaller* more vulnerable bank. Six per cent stated that they were unsure of the impact that bank size would have on their decision to disclose. These results also were consistent across regional areas (research objective 2).

Figure 7: Question 8



Of those stating that bank size did not matter:

Why should I be the judge? They are the ones reading the financial statements and making the loan. Therefore it is their risk, irrespective of their size. (232211)

I do not think it can afford to make a difference. I just do not believe that the auditor can afford to worry himself about the bank; he has enough to worry about with A and B. We are back now to the listing of stakeholders in the audit process. (232611)

Those, in the minority, who said that the bank size would influence them, drew upon reasoning that focused on the stakeholders instead of the "rules of auditing". For example,

I think that it would affect me (if it were a smaller bank) because you are living in a smaller community and everyone knows everyone. So you might do more "wink-wink" (i.e. strongly hinting without saying that a problem exists). (114221)

The impact on the bank and the community will absolutely influence my decision. The only way that you can look at this independently is in an abstract way; yet I know that I cannot judge a situation in an abstract way. (523221)

Finally, when asked about other aspects of the case upon which they would like to comment (Question 9) the auditors suggested that it was important not to

give out incorrect information such as a clean audit opinion would provide (14 per cent), they suggested a new audit rule would be appropriate for disclosing this information (14 per cent), that this was a legal issue (14 per cent), and that it would be appropriate to use the firm's professional committee to make such a complicated decision (21 per cent). The other responses were varied and not duplicated between auditors.

CONCLUSIONS

Overall, we saw noteworthy differences in the way that auditors would interpret and make decisions with respect to a specific case emphasising confidential client information. This suggests that while an individual may be aware of the rules governing the importance of adhering to the principle of confidentiality there may be substantial differences in the actions of auditors when applying this important rule. Such differences should be of interest to the stakeholders of the financial statements since auditors' interpretational differences may influence the ultimate outcome of the audit whereby an audit client would garner either a clean or a qualified audit opinion. While certainly important to the process, the setting of rules and regulations including a Code of Professional Conduct may not have as wide a reach as the profession and other regulators might hope. The personal, cultural and professional experiences of an individual auditor might well impact the decision made and thus the ultimate outcome of the audit opinion. The influence of these factors must not be ignored but should be included in the process of setting such codes in order that they have the outcomes desired.

Furthermore, the observed variations between countries of different western European regions in the adherence to the rule of confidentiality are also bothersome. In a world economy where international companies are attempting to have their stock listed on exchanges in multiple countries, the existence of different accounting and auditing principles from country to country has become problematic. One often proposed solution is to have the financial market regulators in one country recognise the accounting and auditing principles complied with in the company's home country (i.e. "mutual recognition"). However, when we see such significant between-country or -region differences in the application of a basic principle, such as auditor confidentiality, that is common to all countries, we are drawn into doubt regarding the reliability and acceptability of a broad application of mutual recognition. The seriousness of this problem is exacerbated when one includes these findings with other research that has shown significant between-country differences in the application of other basic auditing principles such as auditor independence and materiality (Arnold et al., 2001; Arnold et al., 1999).

This exploratory research has certain limitations which could be addressed in subsequent research. First, all subjects interviewed were from the largest international auditing firms. The size of the audit firm may influence the decisions made by the auditors. Not having investigated the smaller international and national firms limits the generalisability of the study. Additionally, all the auditors

interviewed were from western Europe. Further research should investigate audit firms of disparate size and geographic locations.

Limitations can also be found in the interview format of this research. This format requires that the researcher attain the proper balance between a very structured interview, which allows for a more quantitative analysis, and a free-flowing format of discussion, which allows for a greater breadth of thoughts from the interviewees. The final limitation is from the translation and transcription process. This can be exaggerated when the native language of the individuals being interviewed is not the language of the interviewer, often resulting in having the interviewee not always expressing their ideas in complete sentences and searching for the correct translated word.

NOTES

- 1 When gathering the professional rules on confidentiality, we contacted various partners in the eight countries. They indicated that their country's rules on confidentiality were the determining factors guiding such action. None of them made any reference to individual firm rules that varied from those of the country.
- 2 After preliminary discussions, the one German that had initially indicated a willingness to participate withdrew without any explanation.
- 3 In addition to the research reported upon here, the researchers used this same case as the basis of a written questionnaire in another study (distributed at the same time) to 287 auditors in the same countries. That study was limited to selected responses given either as a probability of the subject in the case taking a single specific action or as a point on a Likert scale indicating the importance of specific considerations in reaching that conclusion. That research did not provide any opportunity for the open ended type of response as used in the current study.
- 4 The discussion provided below of each of the questions asked of the subjects relates to research objective 1 unless otherwise noted.

APPENDIX 1

Selected quotations from individual country rules on confidentiality

Ireland:

'The general obligation of a member is that he should never disclose or use, outside his firm, whether in his interest or that of another party, information received by him in confidence unless he has a right or obligation to do so or he has received informed consent from the party to whom the duty of confidentiality is owed. A member must not disclose confidential information to a client even though the information is relevant for an engagement...' (Ethical Guide for Members of the Institute of Chartered Accountants in Ireland, pp. 70-71).

England and Wales is almost identical to Ireland.

Netherlands:

A registeraccountant shall treat as confidential everything that has been entrusted to him as such in the course of his duties or what has come to his notice as confidential, unless required otherwise by or in accordance with the law..... A registeraccountant shall not make any further or other use of, or

further publish, any confidential information that has come to his notice in the course of his duties, in any other way or for any other purpose than that required by or in accordance with the law for the performance of his duties. (By-laws Governing the Rules of Professional Conduct and Practice of Registeraccountants (1994) Section III, Article 10).

Denmark:

'Any person with Inside Information may not disclose such information to any other party unless such disclosure is made within the normal course of the exercise of their employment, profession or duties' (Section 36 (1) of the Danish Consolidated Act of Securities Trading)

Sweden:

'An auditor may not use information obtained during the course of his or her professional work for his or her own benefit or to the detriment or the advantage of another person. Nor may the auditor disclose such information without authorisation' (Section 26 of the Auditors Act of Sweden).

France:

'...auditors, and their associates and experts, are bound by professional secrecy in regard to any facts, acts and information they have knowledge of on account of their functions' (French Commercial Code: Article L822-15)

Italy:

'an auditor owes a duty of confidentiality to its clients' business with respect to any information gathered in the performance of his work....The duty of confidentiality must always be observed by the auditor, except where disclosure of information is expressly authorised by the client or is mandated by Italian law.' (Italian Auditing Standards No. 200)

Spain:

'the auditor has to maintain strict confidentiality about all of the information acquired in the audit period concern the business affairs and dealings of his/her client and ...he/she will not reveal or disclose the content of said person (who is being audited) without exclusive authorisation of the client'.

APPENDIX 2

Case study

An auditing firm serves as the auditor for both Client A and B. Client A, a major employer in an economically depressed small town, receives a major portion of its business from a contract with Client B. Client A has been in financial difficulty for some years as its financial viability is in question. If it ever became evident that client A would lose the contract with Client B, the auditing firm would probably issue an opinion that expresses the auditor's DOUBT about Client A's ability to STAY in business.

Client A has been putting forth a major effort to find new customers to supplement its business and has begun to achieve some success. They are currently negotiating a significant loan from a local bank. While this bank realizes that the loan would be risky (especially for a small town bank of its size) and would have serious implications for its own financial position if the loan were defaulted on. They are proceeding with granting the loan because they believe that they have an obligation to the local community. The bank will not give the loan, however, until they have a chance to look at this year's audited financial statements for

Client A. After reviewing the unaudited preliminary information, the bank indicated that the loan will be granted if Client A receives a "clean audit opinion."

While auditing Client B (a larger company in another city), Mary, the audit partner on both client engagements, discovers that Client B will not be renewing its contract with Client A. Mary realises that when Client A loses the contract, it will probably be forced into bankruptcy. However, Client B will not be disclosing this information until after the audit report of client A must be signed. Mary is confident that Client A does *not* know of this upcoming disaster and further audit work would not disclose it. Mary discusses the problem with Client B's president who firmly states that this information is not to be revealed at this time. Client B has been an audit client for A NUMBER OF YEARS. Recently, Mary's firm has been attempting to generate some consulting engagements with Client B.

It becomes obvious that if Mary issues a going concern opinion for Client A, it would be equivalent to divulging private information. Client B might be lost as a client. However, if Mary does not divulge the information, the bank will make the loan with the full impact on the bank and the community.

Questions:

1. What would you do in Mary's position and why? (NOTE: *This was the first question asked*)
2. At the end of the day, what do you do? (NOTE: *This question was asked at the end of the interview to see if, having discussed the other questions, the response would be different than given for Question 1. In each case, the reply remained consistent with that given for Question 1*)
3. Would you put pressure on Client B to disclose cancellation earlier?
4. Would you try to get the bank *not* to make the loan without saying the reason?
5. Would you resign from being the auditor of Client A?
6. Would you resign from being the auditor of Client B?
7. Can you audit both companies?
8. Would it have made any difference in your answer if the bank had been a large bank?
9. Is there anything else you would like to mention?

APPENDIX 3

Coding for identification of quotes

1st digit: Country

- 1 = Denmark
- 2 = UK
- 3 = France
- 4 = Ireland
- 5 = Italy
- 6 = Netherlands
- 7 = Spain
- 8 = Sweden

2nd digit: Region

- 1 = Northern Europe (Countries 1, 6 & 8)
- 2 = Southern Europe (Countries 3, 5 & 7)
- 3 = UK/I(Countries 2 & 4)

3rd digit: Firms 1 - 4 (kept anonymous per agreement with firms)

4th digit: Identification of individual subject (kept anonymous per agreement with firms)

5th digit: Staff level

1 = Partner

2 = Manager

6th digit: Gender

1 = Male

2 = Female

REFERENCES

Adams, B.L., Malone, F.L. and James, W. (1995). Confidentiality Decisions: The Reasoning Process of CPAs in Resolving Ethical Dilemmas, *Journal of Business Ethics*, Vol. 14, pp. 1015-1020.

Arnold, D.F., Sr., Bernardi, R.A. and Neidermeyer, P.E. (1999). The Effect of Independence Decisions Concerning Additional Audit Work: A European Perspective, *Auditing: A Journal of Practice & Theory*, Vol. 18, Supplement, pp. 45-67.

Arnold, D.F., Sr., Bernardi, R.A. and Neidermeyer, P.E. (2001). The Association between European Materiality Estimates and Client Integrity, Culture, and Litigation, *International Journal of Accounting*, Vol. 36, pp. 459-483.

By-laws Governing the Rules of Professional Conduct and Practice of Registeraccountants 1994 (GRB-1994).

Commercial Code of France (Legislative Part), Title I, The Commercial Act.

Commissione Paritetica per la Statuzione del Principi di Revisione, Document No. 200, Principle No. 1 of Appendix

Danish Consolidated Act of Securities Trading.

Edelstein, L. (1943). *The Hippocratic Oath: Text, translation, and interpretation*. Johns Hopkins: Baltimore, MD.

Hofstede, G. (2001). *Culture's Consequences*, Thousand Oaks, California: Sage Publications, Appendix 5.

Institute of Chartered Accountants in England and Wales, Guide to Professional Ethics.

Institute of Chartered Accountants in Ireland, Ethical Guide for Members.

International Federation of Accountants (1999). *Code of Ethics for Professional Accountants. Worldwide Web*.

Italian Criminal Code, Article 622.

Lauder, N. (2004). Privilege Versus Transparency: Two Worlds Collide, *Taxes*, Vol. 82, No 3, pp. 221-236.

Nobes, C. (1983). A Judgmental International Classification of Financial Reporting Practices, *Journal of Business Finance and Accounting*, Spring, pp. 1-19.

Resolucion de 19 de Enero de 1991, del Presidente del Instituto de Contabilidad y Auditoria de Cuentas, por la que se publican las Normas Técnicas de Auditoría.

Rowan, H. (1987). Chinese Walls Prove to be Paper Thin. *CA Magazine* Vol. 120, No. 10, pp. 50-51.

Swedish Auditors Act (Revisorslag SFS 2001:883).

Wigmore, J. (1961). Evidence in Trials at Common Law Section 2290, *McNaughton Review*.