

Audit fees and auditor independence: The case of ISO 14001 certification

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ABSTRACT

This study analyses the effects of audit fees and the clients' financial power on the independence of ISO 14001 auditors on the basis of a qualitative analysis of interviews with 36 professionals involved in the certification process. The results of the study demonstrate that most respondents support the legitimacy of the current remuneration system based on the user-pays principle, despite its business and financial ramifications, claiming that the independence of auditors is in fact ensured by the imposition of contractual duty, the observance of ethical codes, distancing the auditor from negotiations with the client, and dissociating the fee charged for the audit from the granting of the ISO 14001 certificate. However, the study demonstrates that auditors often adapt their behaviour to the client's economic context and the company size, which may call into question the prevailing opinion on the independence and impartiality of the certification process. This paper, on the one hand, discusses the manner in which auditors legitimize the current remuneration system and, on the other, describes the potential threat that it represents for their independence. The paper also highlights the similarities in this regard between the conflicts of interest in the field of environmental audits and in that of financial audits. Finally, the paper analyses a number of possible solutions to reduce the financial dependence of auditors on the audited companies.

Keywords: independence, fees, business relationship, ISO 14001 certification, auditing, conflicts of interest, financial dependence

INTRODUCTION

Since its publication in 1996 by the International Standardization Organization, ISO 14001 on Environmental Management Systems (EMS) has gained great popularity among organizations, and more than 257,000 certificates were registered in 2010 (ISO, 2010). According to the standard, an EMS based on ISO 14001 is 'part of an organization's management system used to develop and implement its environmental policy and manage its environmental aspects' (ISO, 2004a, p. 2). The process of certification with the standard aims to demonstrate that the organization complies with relevant legal requirements, puts in place measures and procedures aimed to prevent pollution generated by its interaction with the environment, and implements procedures for continuous improvement (Andrews *et al.*, 2001; ISO 2004a; Mil-Homens, 2011). Inspecting the requirements of ISO 14001 EMS for certification needs is carried out by auditors of an independent accredited certification body (Andrews *et al.*, 2001; ISO 2004a, 2006).

For the environmental management system ISO 14001 external audit to be credible, certification bodies and their auditors need to be independent from the company seeking certification (auditee or client) (Ammenberg, Wik & Hjelm, 2001; Andrews *et al.*, 2001; Burdick, 2001; Boiral & Gendron, 2011). In practice, however, this independence appears to be compromised by the contractual and business relationship between the company seeking certification and the certification body. In this relationship, the certification body is remunerated by the company seeking certification. After contractual arrangements, the certification body sends its auditors (permanent or contractual employees) to audit the company's EMS. The audited company is supposed to obtain the certification if the auditors' verification confirms that the EMS complies with the ISO 14001 requirements. The certification is granted for a period of three years. The certification process is therefore based on a three-year cycle, during which the contract between the certification body and the company may or may not be renewed. Because auditors are paid by certification bodies which are, in turn, paid by audited companies, the certification process is not free from economic considerations. Therefore, the ISO 17021 standard emphasizes the threats of economic dependence, and defines the requirements for the operation and independence of certification bodies (ISO, 2006).

Although the academic literature focuses on several implications of ISO 14001 external audits (e.g., Ammenberg *et al.*, 2001; Burdick, 2001; Darnall, Seol & Sarkis, 2009), to our knowledge, no studies appear to have focused on the specific threat of auditors' financial dependence in the field of ISO 14001 certification. Only the works by Ammenberg *et al.* (2001), Andrews *et al.* (2001), Burdick (2001) and Mil-Homens (2011) briefly address the issue in general studies on the environmental management systems and the certification process. To our knowledge, nor has the issue been addressed in the academic literature on ISO 9001 quality management systems (e.g., Beckmerhagen *et al.*, 2004; Poksinska, Dahlgaard & Eklund, 2006; Power & Terziovski, 2007). ISO 9001 certification is in many respects similar to ISO 14001 certification (e.g., ISO, 2006; Darnall *et al.*, 2009; Boiral, 2011) and it has been adopted by more than one million organizations across the world (ISO, 2010). Nevertheless, ISO certification audits and the issue of auditor independence have remained overlooked in the literature.

The main objective of this paper is to explore the effects of audit fees on the independence of ISO 14001 auditors. This issue is critical given the large number of certified organizations and the importance of auditors' independence in ensuring the legitimacy of the ISO certification process. The threats to this independence were outlined in 2001 by the former Secretary-General of ISO, who requested certification bodies to 'police themselves' in order to avoid conflicts of interest (ISO Management Systems, 2002). These potential conflicts of interest are fuelled by the fact that 'the organizations pay substantial fees to registration agencies for their certificate' (ISO Management Systems, 2002, p. 58). Although the impacts of such economic dependency remain underexplored in the literature, it seems reasonable to assume that it can undermine the auditors' independence and the legitimacy of the ISO certification process. As pointed out by the Environmental Data Services (2003, p. 20):

A certified EMS is only as good as the company implementing it. If the top management just wants a greenwash or a badge on the wall, then there are certification bodies out there that will do that – i.e., give certification based on intent rather than actual evidence.

Generally speaking, the issue of independence is central to the audit process, which requires a certain distance between the auditor and the audited company. As a result, any aspect which might call the process into question, and possible solutions aimed at increasing the impartiality of audits, constitute a major concern which applies not only to the ISO 14001 certification, but to all types of audit by a third party who is supposed to act in an independent manner.

The rest of the paper is organized as follows: The first section presents the main studies on the implications of the financial dependence of the certification body on the client, based on the fields of both ISO certification and financial audit, which remain the most studied by far. The second section describes the methodology applied for collecting and analysing the data. The third and final section presents the results of the study, with particular focus on perceptions concerning remuneration and the financial power of clients on auditor independence, as well as possible solutions to prevent potential conflicts of interest in the process of ISO 14001 certification.

ISO 14001 CERTIFICATION AND AUDITOR INDEPENDENCE

The ISO 14001 standard requires organizations to adopt an environmental policy with measurable objectives relevant to the environmental aspects identified through documented processes. In addition, the policy must implement procedures for conducting and controlling the activities of EMS. These include, among other responsibilities, training, internal audits, reports, management review, etc. (Andrews *et al.*, 2001; ISO, 2004a). The system is based on traditional management principles (plan, do, check, act), and its implementation is verified through a certification audit whose objective is to ensure the stakeholders of the organization's compliance with the requirements of the ISO 14001 standard. According to the ISO 17000 guidelines, the certification audit can be defined as a 'systematic, independent, documented process for obtaining records, statements of facts or other relevant information and assessing them objectively to determine the extent to which specified requirements are fulfilled' (ISO, 2004b: 4.4). The principle of independence is considered by both the ISO standards and literature on this issue to be essential to the credibility of the certification process.

Audit fees and auditor independence: the case of ISO 14001

ISO 14001 certification audits of environmental management systems are normally performed by accredited certification bodies, which conduct their activities on a for-profit basis through their auditors. Generally speaking, the choice of registrars (or certification bodies) and determining their fees depends on the client's organization. According to the Environmental Data Services (2006), the main factors that guide the choices in this matter are: the quality of the submission, the experience developed in audit, knowledge of the scope of the organization's activities, cost, past certification contracts with the organization and the reputation of the organization. Once this choice is made, the certification body and the client organization enter into a contractual relationship in which the latter pays the former to assess its system through an independent audit and to certify it. This remuneration mode can undermine the independence of the audit, as 'auditors and assessors, certification bodies and accreditation bodies, all depend economically on the entities that they supervise' (Mil-Homens, 2011, p. 152). Although the principle of auditor independence is of paramount importance for the credibility and legitimacy of the certification audit (Flint, 1988; Power,

1997b; Lang, 1999; ISO, 2006), very few studies have been conducted on this issue in the context of ISO 14001 certification.

In general terms, independence implies the absence of external pressures or personal relationships that may compromise the objectivity and integrity of auditors exercising their responsibilities (Flint, 1988; Mahony, 1995; Lang, 1999; Independence Standards Board, 2000). In the context of ISO 14001 audits, Lang (1999, p. 112) defines independence as ‘the objective and unobstructed inquiry by an independent environmental auditing function to avoid potential conflicts of interest and the marring of objectivity by personal relationships’. Therefore, auditor independence presupposes the existence of a personal and professional distance between the auditor and the audited client as well as an impartiality of judgement, that is to say the lack of any bias or a conflict of interest. Such a dissociation concerns not only conducting the audit itself, but also relationships with audit clients and the organizational context within the auditor’s firm (ISO, 2006). In principle, this distance serves to strengthen the perceived impartiality of the auditors and to prevent bias in their judgement (Flint, 1988) in order to communicate to stakeholders that the audit process is in compliance with standards and the auditors are professional.

The independence of ISO 14001 auditors appears to be a prerequisite to meeting the key objectives associated with the implementation of the standard: improving corporate image, establishing a tender process which requires ISO 14001 certification, corporate self-regulation and governance (Kitazawa & Sarkis, 2000; Ammenberg *et al.*, 2001; Potoski & Prakash, 2005; Boiral, 2007). However, in practice, the financial and business aspects of the ISO 14001 certification process seem to somewhat disrupt the ideal of auditor independence. Indeed, by establishing a contractual relationship between clients and auditors, the organizational framework of the ISO seems to undermine the logic of dissociation, which is necessary to prevent conflicts of interest (Lang, 1999). As emphasized in the ISO 17021 standard on the requirements for bodies providing audit and certification of management systems:

Being impartial, and being perceived to be impartial, is necessary for a certification body to deliver certification that provides confidence. It is recognized that the source of revenue for a certification body is its client paying for certification, and that this is a potential threat to impartiality. (ISO, 2006, p. 3)

In this light, a situation in which auditors are economically dependent on the audited organizations (Andrews *et al.*, 2001; Burdick, 2001; Mil-Homens, 2011) represents a threat to their independence. If the impact of remuneration by clients on auditor independence was debated at length in the field of finance (Gul, 1989; Beattie, Brandt & Fearnley, 1999; Bakar, Rahman & Rashid, 2005; Alleyne, Devonish & Alleyne, 2006; Ghosh, Kallapur & Moon, 2009; Li, 2009; Geiger & Blay, 2012), few or no studies have been conducted on the issue in the particular context of ISO 14001 certification. The few studies which address the problem do so without going into any depth, and are a part of broader studies (Ball, Owen & Gray, 2000; Ammenberg *et al.*, 2001; Andrews *et al.*, 2001; Burdick, 2001; Mil-Homens, 2011).

For example, in his comparative study of American and German accreditation systems, Burdick (2001) cited some comments by those interviewed on the subject of the remuneration of certification bodies by the clients and argued that the issue of independence concerned the entire institutional system of ISO certification, which creates an economic dependence of accreditation and certification bodies on the clients. In their study on various aspects of ISO

certification in Switzerland, Ammenberg *et al.* (2001) claim that the remuneration system does not affect the objectivity of external auditors, but in fact motivates auditors to be more rigorous. In his doctoral thesis, Mil-Homens (2011) examines the credibility of the certification process by addressing a number of issues, including the financial dependence of auditors on clients, and, contrary to Ammenberg *et al.* (2001), underlines the contradiction between the system of ISO standards certification, which requires independent audits, and the actual practice of audits, creating the economic dependence of auditors, who are paid by the audited clients. This conflict of interests undermines the credibility of the certification process in general.

While a few studies (Ammenberg *et al.*, 2001; Andrews *et al.*, 2001; Burdick, 2001) describe the possible threats of the mode of remuneration for auditor independence, the key issue for the credibility of ISO 14001 certification has been dealt with mainly in an indirect and general manner. First, observations on this subject are often theoretical (Burdick, 2001) or formulated in the context of much broader studies (Ammenberg *et al.*, 2001) rather than in empirical research dealing specifically with issues of independence of ISO 14001 auditors. Second, the relation of the issue with the problems of independence in financial audits, which has been the subject of many studies, is generally neglected or forgotten. However, despite the particular character of ISO 14001 audits, independence issues related to the fees of the auditors in this field are far from new and they could therefore be addressed by applying the findings of studies on the financial audits (Andrews *et al.*, 2001; Boiral & Gendron, 2011).

The experience of financial audits

The ISO 14001 certification audits and financial audits display a number of similarities, including the principle of independence of the audit and of the auditors (Power, 1997a; Karapetrovic & Willborn, 2000). In both fields, the audit aims at ensuring: (a) social legitimacy and credibility of audits by external auditors, (b) the trust of stakeholders, and (c) the compliance of the systems with standards (Power, 1997a, 1997b, 2003; Boiral & Gendron, 2011). Generally speaking, the practice of environmental audits has been shaped by the exemplification of financial audits (Power, 1997a, 1997b; Etzion & Ferraro, 2010; Boiral & Gendron, 2011). Moreover, most major financial audit firms offer auditing services for ISO 14001 certification (Deegan, Cooper & Shelly, 2006; Manetti & Becatti, 2009). Financial audits and ISO 14001 obviously differ in a number of respects resulting in particular from their object and specific institutional context:

- nature of data verified (financial vs. environmental);
- status (mandatory in the case of the financial audit and voluntary for ISO 14001);
- planning (as opposed to financial audit, in the case of ISO 14001 often prepared with the client; Todea, Stanciu & Joldos, 2011);
- professionalization (standardized for financial auditors; disciplinary diversity for ISO 14001 auditors).

However, numerous studies on the independence of financial auditors and the impacts of the manner of remuneration allow issues to be highlighted, which have been little or not at all studied in the literature on ISO 14001. In the context of the debate, three main sources of financial dependence of the auditor on the client have been identified:

- direct remuneration resulting from a business audit contract (Kaplan, 2004; Gestel, 2005; Moore *et al.*, 2006);

- all sources of income associated with non-audit services (Schulte, 1966; Beattie *et al.*, 1999; DeFond, Raghunandan & Subramanyam, 2002; Bakar *et al.*, 2005; Alleyne *et al.*, 2006);
- client size and financial power (Gul, 1989; Reynolds & Francis, 2000; Windsor, 2005; Li, 2009).

The first aspect of economic dependence of auditors is related to the direct remuneration resulting from a business audit contract, which is often perceived as a fundamental threat to the auditors' objectivity and independence (Kaplan, 2004; Gestel, 2005; Windsor, 2005; Moore *et al.*, 2006). For example, Moore *et al.* (2006) and Kaplan (2004) state that the power of the client to remunerate and dismiss the auditor undermines the credibility of the audit, which is founded on auditor independence. As highlighted in Windsor (2005, p. 179):

The auditor's role, however, is confusing and conflicting. The profession must implement the regulation of accounting and legislative frameworks on behalf of the public interest, yet at the same time have a business relationship with the audited company for private economic benefit.

The business relationship, which has become essential for the survival of audit firms in a highly competitive environment, may encourage these firms to prioritize their financial interests. According to Pasewark and Wilkerson (1989), determining fees, financial arrangements and the rewards which bind the client and the auditor can have a negative impact on the auditor's objectivity and independence. For example, unreasonably high fees can limit the independence of the auditor, who feels indebted to the client. Also, the client can coerce the auditor by threatening to terminate the contract without paying the fees. However, some studies suggest that no obvious relationship obtains between the level of remuneration and compromising the auditor's independence (Barkess, Simnett & Urquhart, 2002; Craswell, Stokes & Laughton, 2002). For example, Craswell *et al.* (2002) conclude the study of the subject by stating that 'the level of auditor fee dependence does not affect auditor propensity to qualify their audit opinions'. Such arguments can be applied in general to ISO 14001 auditors, whose remuneration is also variable and can be a source of pressure that could threaten the independence of audit certification. However, the existence and the nature of this threat needs to be analysed empirically.

The second aspect of the financial dependency of the auditors is related to the revenue for the consulting services they can provide to the client along with the audit. Although the literature on the subject is quite unequivocal concerning the influence of these services, they are generally perceived as a major threat to auditor independence (Beattie *et al.*, 1999; Bakar *et al.*, 2005; Alleyne *et al.*, 2006; Dart, 2011). According to Schulte (1966), an auditor who provides consulting services adopts in certain situations the role of a consultant, through which he becomes a 'decision maker', an 'employee' or even an 'advocate' of the company, and is, as a result, inclined to prioritize the client's interests in case of uncertainty. According to Reckers and Stagliano (1981), auditors can remain independent if the fees for consulting services remain modest. Other authors believe that providing consulting services does not compromise the auditors' independence (Gul, 1989; DeFond *et al.*, 2002; Umar & Anandarajan, 2004). Some studies even argue that thanks to these services, the auditor may get to know the client better and be more objective (Wallman, 1996; Goldwasser, 1999). However, financial scandals like that of Enron have clearly undermined such optimism. The Sarbanes-Oxley Act, implemented in the wake of these scandals, now formally prohibits an auditing firm or one of its partners from providing consultancy services to the same client

(Kaplan, 2004). Unlike financial audits, ISO 14001 audits are largely unregulated. However, offering consulting services by certification bodies is in principle prohibited by the ethical rules of ISO audit practice (ISO, 2006).

Thirdly, the auditors' economic independence may also be at risk as a result of the size of the audit firm and the financial power of the client. A number of studies confirm that the size of the audit firm is related to its propensity to maintain or lose its independence (Gul, 1989; Beattie *et al.*, 1999; Alleyne *et al.*, 2006; Bakar *et al.*, 2005). In fact, small audit firms seem more likely to lose their independence than large firms, as audit reports by big firms appear to inspire more confidence than those by small ones (McKinley, Pany & Reckers, 1985). Whatever the context, the influence of economic dependence of the audit firm on its client seems to depend on the number of clients and the level of income generated by them (Li, 2009; Dart, 2011). Indeed, a large firm may have diversified sources of revenue and a number of clients, which allows it to avoid entering a close relationship with one client, which a small firm may be dependent on. Moreover, large firms find it easier to separate consulting and audit services. In the case of a large firm, its resistance to compromising its independence seems to rely on its financial independence and organizational capacity. If those factors are absent, the financial power or the financial condition of the client poses a threat to the independence of the auditors in the exercise of their responsibilities (Reynolds & Francis, 2000; Windsor, 2005). However, although the general perception of the independence of the audit firm is contingent on its size and income, the role of these factors is relative. In fact, large audit firms are not immune to the loss of independence, as shown by the role of the Arthur Andersen auditing firm in the Enron scandal. Moreover, taking into account certain parameters, especially the history of relations between audit firms and their clients, Gul (1989) argues that the client's financial situation does not have a major impact on the auditor. Even though the debate on the impact of the audit firm size and of the financial power of the client certainly applies also to ISO 14001 audits, to our knowledge, the issue has not been a subject of empirical studies.

Research into the independence of financial auditors makes it possible to highlight potential problems related to the impact of auditors' fees on the independence of the ISO 14001 audits. In order to reach a better understanding of these issues, the present study focuses primarily on two questions referred to in the literature on financial audit: first, the fact that the fees are paid by the client, and second, the financial power (or size) of the audited organization. The study does not take into account the influence of financial dependence due to providing consulting services, which is prohibited by the ISO 17021 standard on the requirements regarding the independence of ISO 14001 certification bodies (ISO, 2006).

METHODS

The present study focuses mainly on analysing the perceptions of auditors and professionals involved in the process of ISO 14001 certification concerning the impact of the payment method and the size of the audited client on auditor independence. In order to better grasp the perceptions of participants, a qualitative and inductive approach based on semi-structured interviews (Strauss & Corbin, 1998; Miles & Huberman, 2003; Suddaby, 2006) is adopted in the study.

Sample selection

In total, 36 participants involved in the process of ISO 14001 certification in Canada were selected for a field study. In order to limit the bias resulting from the study of a single category of respondents (auditors), the study focused on a number of professionals who are more or less directly involved in the ISO 14001 audits:

- seven permanent employee ISO 14001 auditors working for four different registrars;
- eight freelance or contractor ISO 14001 auditors (private consultants and independent auditors for different registrars);
- six managers of certification bodies (registrars) with experience in ISO 14001 audits;
- three Standard Council of Canada (SCC) auditors involved in the certification and verification of ISO 14001 certification bodies;
- nine consultants of environmental management systems involved in the implementation of ISO 14001 and the preparation of certification audits;
- three environmental managers of organizations which have recently obtained ISO 14001 certificates.

Participants were initially selected from the databases of Canadian approved auditors associations (selection of ISO 14001 auditors and audit firms). However, referencing and snowball sampling (Miles & Huberman, 2003) were necessary in the case of most respondents. Thanks to participants recommending other respondents, it was possible, on the one hand, to target relevant respondents who were familiar with the topic, and, on the other, to foster a climate of trust. The persons recommended also found it easier to accept to participate in the study than those who were contacted directly. One of the selection criteria was the participants' experience of two years in the field of ISO 14001 certification in order to ensure that they had a good knowledge of the topic (Creswell, 1998; Gendron, Suddaby & Lam, 2006).

Data collection

Data collection was performed on the basis of an interview guide which had been pre-tested on 12 participants. Each interview was recorded electronically. Limiting the number of interviews was justified by three factors: first, the phenomenon of theoretical saturation (Creswell, 1998; Strauss & Corbin, 1998) – if there are more than 20 interviews, the information provided by participants does not provide substantial added value to the already collected data; second, the difficulty of processing a large volume of information from qualitative interviews (Creswell, 1998); and third, the availability of respondents, who did not always accept to participate in a study focusing on the ethical aspects, which are particularly sensitive.

The interviews were based on a semi-structured interview guide focused on issues such as the remuneration of certification bodies by the client and the clients' financial power and their impact on auditor independence. Appendix 1 summarizes the main questions in the interview guide. Interviews lasted an average of 1.5 hours. Just like in other qualitative studies (Trief *et al.*, 2003; Stephens, 2007; Holt, 2010), interviews were conducted by combining face-to-face (20 in total) and telephone (16 in total) interviews. According to Stephens (2007) and Holt (2010), combining such modes of data collection does not affect the ability to compare the results. In fact, no significant difference has been found between the responses obtained by telephone and those arising from direct interviews. Telephone interviews were necessary to reach certain participants in remote locations in Canada or in less easily accessible areas (Trief *et al.*, 2003; Stephens, 2007).

Finally, in order to complete the interview data, a number of general documents submitted by participants or collected from relevant websites were analysed. These concerned: codes of ethics, structural organization in some certification bodies, conflicts of interest, mandatory declaration forms, etc. They served for verifying or consolidating some information provided during interviews (Strauss & Corbin, 1998).

Data analysis

Electronically recorded interviews were transcribed *in extenso* using word processing software. All transcripts obtained were then transferred to the NVivo 7 qualitative analysis software. The process of data analysis was based on grounded theory, which is often applied in qualitative research as it helps to focus the analysis on data collected in the field rather than on assumptions based on theoretical concepts (Strauss & Corbin 1998; Locke, 2001; Thomas, 2006). The inductive approach to classification offered by the grounded theory made it possible to structure and merge the data with the help of the NVivo 7 software into units of meaning in the form of categories, with a view to facilitating their interpretation. The coding process was based on the NVivo 7 software, which facilitated data classification and sorting and searching for relevant excerpts from interviews. A total of 30 categories related to the objective of the research emerged from the analysis of the data. These 30 categories can be grouped into four themes:

1. legitimacy of the ‘client–supplier’ logic underlying the remuneration system of the certification bodies (5 categories);
2. possible impacts of remuneration by the client on auditor independence (11 categories);
3. possible impacts of the client’s financial size on auditor independence (6 categories);
4. possible solutions (8 categories).

The findings of the study were grouped around these four main themes in the study results. As there were no significant differences from one category of respondents to another in response to most questions posed on the different themes, in most cases, it did not seem relevant to conduct an analysis of the results by respondent category (permanent auditors, freelance auditors, managers of certification bodies, etc.). When possible, the proportion of interviewees sharing the same viewpoints and the differences between respondent categories are indicated. Nevertheless, the qualitative nature of interviews make it difficult if not impossible to provide precise statistics on the frequency or intensity of specific variables, quotes or ideas in order to measure the main findings.

STUDY RESULTS

Legitimizing the client–supplier relationship

Data analysis demonstrated that most respondents considered the business relationship between certification bodies and audited companies to be normal and legitimate. In fact, approximately 75 per cent of respondents voiced the opinion that the practice of remuneration by the client following from the client–supplier relationship is a normal or even satisfactory state of affairs, and they attributed it to the institutional and economic context of ISO 14001 certification. According to approximately 65 per cent of respondents, the practice of the

auditor being remunerated by the client is institutionalized through practices based on the ‘user-pays’ principle, which are applied in other, more established types of audits that have existed for longer, notably ISO 9001 certification and financial audits. In this study, the ‘user’ is the company seeking certification or the audited party. As a client, the company must pay for the auditing activities offered by the certification body. The ‘user-pays’ principle, which implies that auditors are paid by the audited party, applies not only in the context of a company seeking certification, but also for accreditation bodies such as the Standard Council of Canada (SCC), which supervises the certification bodies. Accreditation bodies are themselves under the supervision of the International Accreditation Forum (IAF). This pyramid structure of monitoring and auditing services is perceived as legitimate insofar as it is overseen by national (SCC) and international (IAF) public bodies. Approximately 65 per cent of respondents also believed that the ISO standards procedures and all certification processes are situated in the context of private for-profit entities, which justifies the ‘client–supplier’ logic. Therefore, certification bodies, as economic agents, are also providers of audit services which meet the demand of client organizations. According to respondents, remuneration by the client as a result adheres to the market supply and demand context. The following excerpts are representative of the manner in which the respondents justified their perception of the business relationship between the audited client and the auditor as normal:

ISO 14001 and ISO 9001 systems are based on a voluntary participation. No one is forcing anyone. Ultimately, this is a client–supplier relation. So, if a company decides to implement the standard, it will have to deal with all the resources which will enable it to implement the system, just as in the case of an accounting system. The company must necessarily employ third parties and pay them. Otherwise, this would not be feasible in a private context. (Permanent Auditor 5)

While the majority of respondents believed that the auditor remuneration method which follows logically from the client–supplier relationship is a normal state of affairs, approximately 25 per cent perceived that the auditors’ role as ‘service providers’ constitutes a problem when they decide whether to grant a certificate to the audited company. However, also these respondents seemed to accept the present state of affairs, by adopting a relatively conservative and disillusioned stance: if they in some cases posed questions on alternative solutions in some cases, they normally left those unanswered:

The only problem is that the registrars are paid by the firms that they will audit. I see no way in which that could be solved. (Environmental manager 3, certified organization)

We are making money because we accredit certification bodies. They’re making money because they are certifying companies in the market to ISO 14001, right? We have a dilemma here because we are also making decisions. (Certification body evaluator 1 from the SCC)

Audit fees: a direct threat to auditor independence?

Although most respondents agreed that the method of remunerating certification bodies resulting from the client–supplier logic is normal and legitimate, they reacted in a much more varied manner when more specific questions about impacts on auditor independence were asked. These responses ranged between two opposed stances:

- The auditor remuneration model has no impact on the independence of ISO 14001 audits, or even plays a positive role;

- The remuneration of ISO 14001 auditors has potentially negative effects on their independence.

The first of those opinions was asserted by approximately 55 per cent of respondents, including all 15 auditors participating in the study. According to this optimistic stance, remuneration of certification bodies by the audited clients does not have a negative impact on the objectivity and independence of auditors. This optimistic attitude was based mainly on three types of justifications, which are not mutually exclusive:

- citing the contractual framework of the audit;
- questioning the existence of pressure related to financial aspects;
- pointing out the ethical and institutional framework of the certification process.

On the one hand, approximately 50 per cent of the respondents observed that the certification is conducted on a contractual basis, with the obligations of the parties clearly defined in order to ensure the independence of the certification bodies. Within the process, the client has the obligation to pay the remuneration, and the organization, to achieve a system conformity assessment with independent professional auditors who are not in a position of a conflict of interest. In this optimistic perspective, the clients are perceived to expect the audit to be thorough and objective, as they wish the certification process to produce a real added value. In fact, clients could even file complaints if the auditor fails to comply with the contractual obligation of independence, although no actual cases of this were reported by the auditors. Two respondents from the SCC acknowledged that it is possible for the auditor to become complacent in respect to this obligation, though they emphasized that this is in fact very infrequent.

On the other hand, approximately 45 per cent of the respondents questioned the existence of pressures related to financial aspects. The argument most often mentioned to justify that stance was the fact that the client does not pay the auditors directly, but rather their employers, that is to say, the certification bodies. According to respondents, the auditors do not personally participate in the financial contract negotiations, which are the responsibility of the customer service. Moreover, the salaries of employees or freelance auditors are in general not proportional to the value of contracts signed with clients. Additionally, approximately 25 per cent of respondents noted that the remuneration paid by the client is not contingent on obtaining the ISO 14001 certificate, but rather results from the fees for auditing the environmental management system. According to these respondents, undertaking to undergo the audit process does not guarantee obtaining the ISO 14001 certificate, which in fact limits the financial dependence of the auditor on the client.

Finally, some respondents upheld the optimistic position that the auditors' remuneration produces no negative impact, pointing to the ethical and institutional framework of the certification process. In fact, approximately 30 per cent of the respondents underlined the importance of these rules, whose enforcement is overseen by the SCC, in preventing threats to auditor independence. The SCC's role consists in monitoring and promoting good audit practices among certification bodies in a number of manners: informing and training auditors; conducting audits of certification bodies; monitoring the enforcement of ISO 14001 standards on auditing (in particular ISO 17021 and ISO 19011; ISO, 2006 and 2002, respectively); disciplinary sanctions in cases of non-compliance with ethical rules, etc. A number of respondents mentioned the risk of auditors being dismissed or facing disciplinary sanctions for non-compliance with ethical standards.

The following opinions are representative of the arguments cited by the respondents who believe that auditor independence is not threatened by the method of remuneration by clients:

The system is voluntary, with established ethical rules and operation principles. It is a market service. The client does not pay for the certificate, but for an audit leading to obtaining it. (Lead Permanent Auditor 4)

Billing for services is not my job, so money matters do not affect my relationship with the client. I do not feel pressure, I've never witnessed a client attempting to bribe me. (Lead Freelance Auditor 4 and manager/ owner of a consulting firm)

In fact, what we want is for the client to improve its system. If we are indulgent with the audited company, I do not think we help them improve. Companies often ask us to give them the straight goods because they need the information to improve. I have never felt my independence being threatened by a business relationship. (Lead Permanent Auditor 2)

On the other hand, approximately 25 per cent of the respondents voiced the opposite opinion, suggesting that remuneration by the client can threaten the independence of auditors. However, this threat was primarily referred to as a more or less theoretical possibility, with very few actual examples provided during the interviews. As noted by one SCC respondent, given the scandals in the financial audit world and the fact that organizations offering financial audit have in recent years moved towards the ISO 14001 certification field, it is implausible that ISO auditors not be exposed to conflicts of interest related to their mode of remuneration. Moreover, the competition and the risk of losing the client to another certification body may lead some auditors to adopt a more indulgent attitude in order to obtain certain contracts. The choice of the certification body by the client could also incite indulgence, and encourage the auditors to interpret the requirements of the standards in a flexible manner. In general, some clients might be tempted to seek out more lenient and less expensive certification bodies, as well as exert a certain amount of pressure in order to ensure the favourable result of the audit. Respondents in this category claimed that auditors are not necessarily immune to these pressures:

There is a dilemma between client relations and certification. Sometimes, registrars have to adjust to the situation or stretch a little the limits of what is acceptable. It does not happen in all the cases. I would say in 30% of cases. Some registrars say to themselves that if they want to keep their client, they better please him, and if they withhold the certification of the company because it does not meet the standard, this will have an impact on their future income. (Freelance Auditor 3 and manager of a consulting firm)

There is the competition between registrars. When a registrar sees that the client wants to hire another auditor, he adopts a more friendly attitude, because he does not want to lose the client. It is in this that the problem of auditor independence resides. However, I think it also depends on people's perceptions. When people see that a company pays its registrar, this does not seem quite credible. (Environment Manager 3, a certified organization)

The influence of client size and resources

Approximately 80 per cent of those interviewed felt that auditor independence is not affected by the financial size and resources of the company. However, as in the case of the mode of remuneration, this rather idealistic vision of auditor independence seems to rely on a quite fragile basis. In fact, approximately one third of the respondents stated that large companies

can actually constitute a source of pressure because of their financial importance for the income of the certification body. These pressures can be manifested, for example, in the threat of cancelling the contract. However, some auditors stated that such pressure was stronger in the field of financial audits than that of ISO 14001 audits, without providing a clear explanation of the difference between the two:

I think there is a difference between financial audits and environmental management audits because of the monetary issues associated. We are not influenced by the financial resources of the company at all. We are hired to make a fair assessment of their process. Our role is not to say how to run their business, but to validate things according to certain standards. (Lead permanent auditor 2)

Paradoxically, even though most respondents rejected the claim that the independence of auditors can be influenced by client's company size, two-thirds of the auditors interviewed on the issue acknowledged that the rigorousness of the audit depends partly on the client's company size and resources. However, contrary to initial assumptions and the trend observed in some studies on financial audits (Li, 2009; Geiger & Blay, 2012), the respondents upheld that clients of considerable size and financial resources would in fact enhance the rigorousness and professionalism of audits rather than constitute a source of pressure that could jeopardize the independence of auditors. In fact, auditors appear to be more flexible as far as the rigorousness and requirements of the audit are concerned in the case of small and medium-sized enterprises (SMEs), which lack the resources for the establishment or maintenance of the environmental management system. At least two auditors reported that they had rather minimalist requirements in the case of SMEs, as it was important to adapt to their resources. One respondent (permanent auditor) compared such adaptation to the case of 'a hospital patient to be treated as his case requires'. If adapting the audit to the resources and the situation of the SMEs may appear legitimate, it seems to undermine the role of the ISO 14001 certification as a manner of ensuring to stakeholders the effective incorporation of environmental concerns in their operation.

First, some SMEs may be heavy polluters and their environmental footprint may be greater than that of larger companies, which have more resources. In this context, the greater flexibility with respect to some SMEs may send the wrong signal to stakeholders as far as both the control of environmental issues and the value of ISO 14001 certification are concerned. Secondly, adapting the audit to the client's size and resources tends to call into question the separation (often mentioned by the respondents) between the business aspects of the audit and its implementation, which is supposed to be impartial and independent of economic considerations. Although none of the respondents mentioned the actual practice of negotiations on the audit requirements depending on the size and financial resources of the client, it can be reasonably assumed that such negotiations are conducted in a more or less implicit manner. Thirdly, the ISO 14001 standard is based on rather conventional management principles, which were designed for application by companies of all sizes and all industries. In this context, the adaptation of the audit to the size and financial resources of the enterprise appears to be at odds with the intent of the standard. Finally, perceptions concerning the size and the financial resources of the audited company may lead to misinterpretations which distance the certification bodies from their primary role of verification. The following interview excerpts clearly show that adapting the audit to the economic situation of the audited companies may be quite arbitrary and lead to a fairly flexible verification of ISO 14001 requirements:

This can affect the quality of the system that you require of the client. The performance threshold that you will require in your audit comments may be higher for a large company than for a small one. I know that for some places I'll propose measures for improvement that I will not propose to other places because I know they do not have the means to implement them. So I make sure that the smallest ones which do not have money comply with the standard to the best of what they can afford to pay, while pushing them to improve where they can. (Freelance Auditor 4, manager of consulting firm)

Large companies allow us to devote enough time to them because they have the means to pay. So we'll spend the time required by the standard to really give them the result they want. On the other hand, small businesses do not necessarily have the resources for in-depth audits and therefore, sometimes we will go over them faster. (Leads permanent auditors 3 & 4)

Challenging the status quo?

While approximately two-thirds of the respondents believe that the current remuneration method can, in theory, pose a threat to auditor independence, very few of them have proposed alternative solutions. In most cases, respondents are in fact in favour of maintaining the current user-pays system, which allows maintaining control over the business aspects of the audit while preserving, at least in appearance, the independence of the auditors, as they are not supposed to participate personally in contract negotiations. In fact, only three respondents (one consultant and two environmental managers of certified companies) proposed a new manner of remuneration for certification organizations, via a body which would perform the role of an intermediary, with a view to preventing the client–supplier relationship between the auditors and the audited companies. This new remuneration mode could be introduced in one of two complementary manners. The first of those would require creating a certification fund managed by a new independent body responsible for financing certification organizations without the latter participating directly in contract negotiations with the audited companies. The second solution would consist in the management of applications by an existing body, e.g. the SCC or the ISO, which would decide which certification body should conduct the certification process of a given company.

Ideally, there should be no relation, and no financial connection, between the auditor and the company. For example, a part of the amount paid by the client to obtain the certificate could be managed by the International Organization for Standardization. The organization would use that money to pay the auditors and ensure their impartiality and independence. (Environmental Manager 1, certified organization)

However, the majority of respondents believe that such a solution would only shift the problem by providing a false sense of confidence and security. In addition, the establishment of a new remuneration model with the participation of an independent body could produce a number of adverse effects: bloating the bureaucratic and administrative system, increasing costs for the clients as a result of introducing another actor, lack of communication between the auditors and certified company, possible misreading of the needs of certain companies as a result of the centralization of application processing, arbitrary selection of auditors, etc.

Whatever the legitimacy of the arguments used to justify the status quo, maintaining the current remuneration system appears to be motivated primarily by economic considerations and the concern of audit professionals that they would lose control of the relations with client companies who currently ensure their source of revenue. However, these economic arguments were rarely voiced directly in the interviews, and most respondents focused

instead on the fact that the current system is satisfactory, and modifying it constitutes a possible risk:

In fact this would be a different manner of managing the process; I'm not sure it would improve it. It would probably lead to increasing tenfold the costs of certification. (Environmental Program Manager, Certification Body 1)

Wouldn't adding another stage in fact create a false sense of confidence, sending the message that there is more monitoring? Are people capable of fully appreciating the present state of affairs? Adding another entity might in fact slow down the issuing of certificates, because the entity would not be sufficiently connected to the auditors who conduct the audits. Currently, there is in fact some communication between the team that conducts the audit and the people who are responsible for issuing the certificate. (Lead permanent auditor 2)

Paradoxically, despite being relatively satisfied with current remuneration practices, most respondents acknowledged the importance of strengthening the independence of auditors. However, the solutions proposed in this area actually overlap with existing practices or concern issues out of auditors' control: strengthening the surveillance of certification bodies by the SCC, applying existing standards on auditor independence (including ISO 17021 and ISO 19011; ISO, 2006 and 2002, respectively), emphasizing professionalism and preventing conflicts of interest through auditor training, etc. Other respondents emphasized the importance of the auditors' reputation and the role of audited companies' desire to prevent conflicts of interest, claiming that the existence of those would undermine the reputation of certification bodies, which would not benefit if they yielded to pressures related to the mode of auditor remuneration. In this context, the activity of the SCC seems to constitute an important element:

The SCC is already working hard to ensure that ultimately the right conditions are in place to allow the registrars to do their job properly. (Certification bodies evaluator 3 from SCC)

DISCUSSION

The present study aims to analyse the effect of audit fees and the financial power of clients on the independence of ISO 14001 auditors, on the basis of the observations of auditors and professionals involved in the certification process. Although the majority of respondents realize that the current remuneration practices could lead to a conflict of interest, few of them believe that it is necessary to modify those. Respondents tend to perceive the certification body as a service provider, which legitimately receives remuneration from the client. The legitimacy of such a remuneration model is confirmed by its use in other areas, including financial audit (Moore *et al.*, 2006), and the monitoring role of well-established organizations, in the Canadian context, the SCC. The acceptance for the current method of auditor remuneration is consistent with the findings of several studies in the field of finance (Craswell *et al.*, 2002; DeFond *et al.*, 2002; Umar & Anandarajan, 2004), which document the view that remuneration by the client imposes the obligation of objectivity and independence on the auditors.

However, auditor independence remains a sensitive and delicate issue, which introduces a social desirability bias (Ammenbergh *et al.*, 2001; Boiral, 2007) into the discourse of audit professionals and audited companies. Despite this bias, the present study demonstrates that some respondents acknowledge that the current remuneration method actually represents a

threat to auditor independence, as discussed by a number of authors (Burdick, 2001; Kaplan, 2004; Gestel, 2005; Moore *et al.*, 2006). Nevertheless, the analysis of respondents' observations furnishes few examples in this area. Most respondents only provide general remarks following highly-mediatized scandals in the field of financial audit, which makes it possible to distance themselves from the problems they describe, and preserve in appearance their professional integrity, which obviously is never truly questioned in interviews.

Contributions

A major contribution of the present study consists in the analysis of the arguments which auditing professionals involved in the process of ISO 14001 certification employ in order to reconcile the mode of remuneration by the audited company with the principle of independence which is at the heart of audit practice. The study provides insights into the level of reflexivity and critical sense which audit professionals display in relation to their professional activity and the method of remuneration which appears a priori at odds with the principle of independence (Burdick, 2001; Kaplan, 2004; Gestel, 2005; Moore *et al.*, 2006). The study reveals a disconnection between, on the one hand, the awareness of the threat and, on the other, the acceptance of the existing remuneration system. This dissociation may be explained by the concern for social legitimacy among the respondents, who are reluctant to openly and directly acknowledge the existence of circumstances which may call their professionalism into question. It can also be perceived as a manifestation of auditors' 'moral seduction' (Moore *et al.*, 2006), that is to say convincing themselves that the conflict of interest problem does not really exist. This perspective is also encouraged by the institutionalization and rationalization of questionable practices. In fact, whatever independence issues it may cause, the existing remuneration method is rooted in the auditors' professional routine. Auditors thus often lack a critical distance towards their practice and are *a priori* reluctant to challenge it. As a result, when the problem of a possible conflict of interest related to the mode of remuneration is discussed, audit practitioners often dismiss this as caused by a poor understanding of the realities of audit practices, whose integrity they claim to be guaranteed by the institutionalization of standards and well-established monitoring mechanisms. This lack of critical distance associated with the phenomenon of 'moral seduction' among audit professionals may partly explain the paradox of, on the one hand, the awareness of the problem of a conflict of interest in the general perspective and, on the other, the virtual absence of questioning the practices which are more directly related to the respondents' personal experience.

The study also contributes to the research into the influence of size and financial power of audited companies on auditor independence. Paradoxically, if respondents tend to call this influence into question, they acknowledge, in fact, that certain pressures to adapt the requirements of the audit to the size of the audited client do exist. However, contrary to the findings of some studies on financial auditing (Gul, 1989; Reynolds & Francis, 2000; Windsor, 2005), most auditors perceive the lack of financial resources of small businesses as the main source of pressure. They also admit to being more flexible in the application of ISO 14001 in the case of SMEs. Moreover, if certain auditors admit adapting the requirements of the audit to the company size, they rarely perceive this as a threat to their own independence, whatever the pressure and size of clients.

The study also contributes to the exploration of possible manners of reducing the risk of conflicts of interest related to the mode of remuneration, in particular through introducing a third party acting as an intermediary between audit firms and companies. Distrust and

criticism voiced towards such a solution by most respondents are related to the unwillingness to change the current remuneration system, which allows audit firms both to control the business aspects of certification and to maintain the appearance of independence in the conduct of audits. The appearance of independence and legitimacy is embedded in routines, standards and monitoring mechanisms which are institutionalized by the activities of the SCC and the ISO standards certification process in general. Maintaining the status quo is one of the possibilities raised by Mil-Homens' (2011) thesis on the ISO 14001 audits. However, the reasons that can justify why the current remuneration system is not put into question have not been dwelt on in depth in the literature on the subject. The present study allows, among other things, an exploration of such reasons, and the difficulties posed by the alternative solutions to the current mode of remuneration: bureaucracy, increased costs to the client, breakdown in the auditor–certifier–client communication, etc.

From a practical standpoint, the analysis of the resistance and challenges pointed out by the respondents may help decision makers to anticipate the reactions to measures aimed at eliminating the client–supplier relationship between auditors and audited companies. However, such measures could prove necessary in order to avoid scandals of the sort reported in the financial field.

Limitations and avenues for future research

The main limitation of the study is related to the nature of the respondent group, which consisted exclusively of persons involved in the certification audits. Although the study focuses on various categories of ISO 14001 professionals, similarities in the responses obtained on the main issues of the study may indicate that the personal involvement in ISO certification and its financial stakes causes significant bias. From this perspective, the relative homogeneity in the responses obtained is in itself an interesting result which may indicate that audit fees threaten the independence of respondents, who depend financially on ISO 14001 audits. While involvement in the certification audits seems necessary to ensure that the respondents are familiar with the subject, it clearly results in a lack of critical distance. A further study could be conducted among the managers or employees of the certified companies. What are their perceptions concerning the impact of the mode of remuneration of the auditors on their independence? To what extent do they feel that they can pressure the auditors to obtain ISO 14001 certification more easily? Do they perceive the size and financial power of their companies as a factor influencing the thoroughness of the audits? To what extent do they find audits credible and professional? Although some studies on ISO certification have cast a critical regard on these issues (Jiang & Bansal, 2003; Boiral, 2007; Mil-Homens, 2011), very little research has been conducted on the perception of audited companies by the independent certification bodies. Such studies could, however, face the same social desirability bias as those concerning auditors. Because of the economic and financial stakes of ISO 14001, it is indeed unlikely that managers and employees of certified companies be more inclined than auditors to criticize the rigorousness of the certification process.

Whatever the method used, the level of auditor independence ultimately depends on subjective perceptions and can therefore hardly be captured objectively. However, the analysis of these perceptions is important in understanding how audit professionals endow their work with meaning and how they attempt to legitimize the existence of threats or contradictions concerning maintaining their own independence, which is at the heart of the certification process.

APPENDIX 1: INTERVIEW GUIDE

This Appendix summarizes the main questions of the interview guide. Some of the questions were adapted to reflect each respondent's specificity.

1. What role do you play in the ISO 14001 certification process in Canada?
2. Which services do the auditors or certification bodies generally provide to companies concerning the environmental management systems?
3. What do you think about the competition in the process of ISO 14001 certification in Canada?
4. How does this competition influence the practices of the auditors and certification bodies?
5. Do you think that all auditors and ISO 14001 certification bodies respect the independence of the audit? Please justify your answer.
6. With regard to the choice of the certification body and the payment of audit fees by the company seeking ISO 14001:
 - a. Which factors, according to you, drive the companies' choices?
 - b. What impact do you think such a commercial relationship has in regard to the objectivity and the independence of the ISO 14001 audit?
 - c. Give a few examples of situations in which, according to you, the commercial relationship influenced the conclusions of the auditors.
 - d. How long does the contractual relationship between certification bodies and their clients last?
 - e. Do you think that auditors tend to remain in a permanent relationship with the certified company? If so, why?
7. In the accounting auditing field, some authors concluded that the economic condition of the client influences the auditor's decision.
 - a. Do you think that auditors face this situation within the framework of the ISO 14001 audit process? If so, why?
 - b. How does the client's economic condition influence the ISO 14001 auditors?
8. What are the institutional or governmental mechanisms for monitoring the independence of the auditors and the certification bodies in the ISO 14001 certification process?
 - a. What do you think about the efficiency of these mechanisms?
9. Do you think that the ISO 17021 standard can really help avoid the conflicts of interest in the process of ISO 14001 certification? If so, how?
10. What measures would you propose for the improvement of the ISO 14001 certification process, as far as the protection of the independence against the economic dependence is concerned?

Specific questions to the accreditation body (Standards Council of Canada, SCC)

1. What role does the SCC play in the ISO 14001 certification process in Canada?
2. Has the SCC already decided in the past to penalize or suspend certification bodies because of their lack of independence or other ethical issues?
3. What is your opinion of the auditor independence in the practice of ISO 14001 audits?

Specific questions to certified companies

1. What organizations have contributed to the implementation and certification of your environmental management system?
2. What do you think about the independence of auditors who have verified your environmental management system in view of the certification?
3. In the context of the commercial contract with the certification bodies, do you think that some companies seeking certification exert pressures on auditors or certification bodies?

Specific questions to auditors and certification bodies

1. To what extent can the commercial contract with the certified company affect your independence?
2. As an auditor, how do you establish that the information and the documents provided by the companies you audit are rigorous, accurate and complete?
3. As an auditor, have you already refused to grant ISO 14001 certification because the company did not comply with the standard? Is it frequent that the audited companies fail to obtain the ISO 14001 certificate?
4. How do you protect your auditor independence in the commercial relationship with the client (audited company)?
5. Could you describe how the final decision to grant or to refuse the certification is taken within your organization? Who is involved in taking this decision?
6. How do certification bodies monitor the integrity of their auditors?

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