

CONFLICTS OF INTEREST IN THE HIRING OF NON-AUDIT SERVICES PROVIDED BY AUDIT FIRMS: ARE THE ANTI-CONFLICT CORPORATE POLICIES ADOPTED IN BRAZIL ADEQUATE?

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ABSTRACT

The present study analyzed the policies and procedures adopted to prevent conflicts of interest situations in Brazilian public companies that hired the same audit firm to perform both the financial statement audit and non-audit services in the fiscal year 2020. Using content analysis, the study examined information available in the Management Reports for the year ended December 2020 which are mandatory disclosures to the market, and in the Policies for Hiring Non-Audit Services of their Independent Auditors in the year 2020, optionally submitted to the Securities and Exchange Commission. The results suggest a low level of detail in the information provided by public companies, as most use standardized and concise texts in their respective Management Reports. Through best practices, it is noted that the Policies for Hiring Non-Audit Services of their Independent Auditors in the majority of analyzed companies identify the Audit Committee as responsible for service contracts. Some companies include a list of prohibited services and establish percentage limits for non-audit services to be provided. As a contribution, the study aimed to outline the policies adopted by companies in response to regulatory requirements and highlight some existing evidence in the disclosed information.

Keywords: Independent audit. Non-audit services. Management report. Policies for hiring non-audit services.

1 INTRODUCTION

The hiring of non-audit services by the same firm that provides independent audit services may increase the risk of conflict of interest and negatively impact auditor independence, potentially affecting the ability to detect errors and fraud in the audited company. Furthermore, accounting scandals resulting from fraud in the early 21st century involving multinational companies such as Enron (2001), Adelphia, WorldCom (2002), AIG (2004), and Lehman Brothers (2010) (Mironiuc et al., 2013), raised concerns about the independence of auditing firms.

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After the mentioned scandals, the North American market strengthened the regulation of auditing services, with the main consequence being the Sarbanes-Oxley Act (SOX) issued in July 2002 (Nardi et al., 2020). The main contributions of this law were: (i) the limitation of non-audit services provided by audit firms to their clients, and (ii) the creation of the Public Company Accounting Oversight Board (PCAOB), which is responsible for setting standards for public companies regarding the hiring of external auditors (Gramling et al., 2012. p. 41).

Changes in legislation were also identified in the European market, particularly after the scandal involving the Italian company Parmalat in 2003. For instance, amendments were made to Article 22 of the Eighth Directive of Company Law of the European Union on June 17 2006 (Braunbeck, 2010). These changes included restrictions on providing non-audit services that could pose risks to auditor independence, notably Tax Consulting, Financial Information Systems, and Human Resources Consulting (Meuwissen & Quick, 2019).

Just like the North American and European markets, Brazilian regulations were also revised. One of the outcomes was the publication of CVM Instruction No. 381 dated January 14 2003. by the Brazilian Securities and Exchange Commission (CVM), which deals with the disclosure of additional information when audit firms provide other services to their audit clients. According to this regulation, the Management Report must provide information about the policies or procedures adopted by audit clients to avoid conflicts of interest, loss of independence, or objectivity with their independent auditors.

To this day, there are controversies regarding the effectiveness of prohibiting non-audit services that can be provided by independent audit firms, in addition to audit services for financial statements (FS), which may raise questions about independence and audit quality (Nardi et al., 2020).

Issues involving auditor independence are primarily related to the fact that at any moment, the client of an independent audit firm may request the performance of additional non-audit services, potentially leading to a conflict of interest between the auditor and the auditee (Rodrigues Sobrinho & Bortolon, 2016). On the other hand, some authors argue that a better understanding by independent auditors of their clients, resulting from the provision of non-audit services, enhances the efficiency and effectiveness of the audit of financial statements without compromising their independence (Chu & Hsu, 2018).

In a recent approach, Mintz (2020) suggests that some audit firms operating in the North American market may be disregarding regulatory directives regarding the provision of certain non-audit services to audit clients, either intentionally or due to a lack of interpretation of the legislation.

Cases involving PriceWaterhouseCoopers (PWC) and RSM US LLP, for instance, reignited market concerns about the concurrent provision of services by independent audit firms, prompting the Securities and Exchange Commission (SEC) to take action (Mintz, 2020). In 2019, PWC was notified by the SEC for violating PCAOB auditor independence rules by providing prohibited non-audit services to audit clients. Previously, RSM US LLP had also been notified regarding the provision of prohibited non-audit services to several audit clients, as documented in AAER 4066 on August 27 2019. In both cases mentioned, the companies involved were penalized by the SEC, with PWC paying fines totaling \$3.500.000 and RSM US LLP paying \$950.000 along with corrective administrative measures (Mintz, 2020).

The application of sanctions was not limited to the North American market. In Brazil, PWC was notified by CVM for providing consulting services to Tupy S.A. concurrently with audit services for the year 2014. The outcome of the case was a settlement between the parties, where PWC and its responsible technical auditor agreed to pay fines to CVM in the amounts of R\$ 650.000 and R\$ 300.000 respectively, as highlighted in CVM Opinion No. 4 dated August 30 2019.

In relation to the revenue of firms providing both services, the market trend observed is an increase in consulting revenues far exceeding audit services. One of the major audit firms, Ernst & Young, experienced a 24.5% growth in consulting revenue in one year, while audit services grew by only 6% (Laurence, 2022). Similarly, at PWC, the fiscal year ending in June 2022 saw a 23.5% increase in consulting revenue, compared to a 7.6% increase in audit service revenues (Rocha, 2022).

It's notable that in the accounting literature, there is a diversity of studies addressing auditor independence concerning additional services compared to audit of financial statements (Ramzan et al., 2020; Oliveira, 2020). Some researchers argue that the length of the relationship between auditor and audited company may raise independence issues (Johnson et al., 2002; Cahan et al., 2008). Another studies examine the influence of providing extra-audit services on the quality of financial reports disclosed by companies (Bloomfield & Shackman, 2008; Ghosh et al., 2009; Wahab et al., 2014; Erik et al., 2021). The impact of providing certain services, from the perspective of various groups such as members of the Audit Committee, accountants, and stakeholders, is analyzed in another strand by Meuwissen and Quick (2019) and Oliveira (2020).

Others studies analyzing the Management Report, such as Ponte and Oliveira (2004), Gallon et al. (2008), and Silva and Silva (2017), provide insights into the relationship between independent audit firms and their clients. However, these studies have focused on the existence rather than the informational content of the Management Report. While Ponte and Oliveira (2004) and Gallon et al. (2008) examined whether the Management Reports complied with specific CVM requirements, Silva and Silva (2017) provided a description of the disclosed information regarding the relationship with external auditors by public companies with CVM in 2015.

In this way, the study aims to answer the following question: **what policies and procedures are adopted by Brazilian public companies to avoid situations of conflict of interest when hiring the same auditing firm to perform both financial statement audits and other non-audit services?**

The importance of this study is related to the analysis of information disclosed in the Management Report regarding the relationship with the external auditor by companies registered with the CVM. Additionally, it examines Policies for Hiring Non-Audit Services from their Independent Auditors, submitted to the CVM, as this document details the policies adopted by the companies. It is worth noting that no study has been identified in the literature that uses this Policy submitted to the CVM.

As a practical contribution, this study provides an overview of information disclosed to the market nationally, in response to requirements imposed by the regulatory body. Additionally, this study offers specific contributions, particularly: (i) to the regulatory body, by presenting evidence of the lack of detail in the information provided by public companies in their mandatory reports to the CVM, regardless of the time elapsed since the legislation was implemented; and (ii) to stakeholders, who require comprehensive and timely information about other audit services that, when contracted, may impact the quality of published financial statements. From a theoretical perspective, this study aims to highlight key published data regarding auditor relationships, encouraging further research.

2 THEORETICAL FRAMEWORK

2.1 Norms regarding the prohibition of non-audit services

The Brazilian market, within the scope of CVM (Securities and Exchange Commission), saw its first legislation detailing prohibited services and addressing responsibilities of administrators with their respective external auditors at the end of the last century, with the establishment of CVM Instruction No. 308/1999.

At that time, the capital market regulatory body already restricted the provision of certain consulting services aimed at auditor independence, such as: (i) organizational restructuring advisory; (ii) company valuation; (iii) asset revaluation; (iv) determination of values for the constitution of provisions or technical reserves and provisions for contingencies; (v) tax planning; and (vi) remodeling of accounting, information, and internal control systems (CVM, 1999).

In 2003 CVM Instruction No. 381/99 was issued, which addressed the disclosure by companies of information regarding the hiring of non-audit services, as some are permissible. The regulatory body established the information that should be included in the Management Report, emphasizing that companies disclose: "the policies or procedures adopted by the company to avoid conflicts of interest, loss of independence, or objectivity of its independent auditors." (CVM, 2003).

In general terms, the Brazilian legislation of 2003 was influenced by North American legislation. The enactment of SOX (Sarbanes-Oxley Act) on July 30 2002 marked a milestone in the global auditing landscape. Silva and Robles Junior (2008) reinforce the idea that it was the most significant legislation in the North American capital market since the 1929 crisis, characterized by the collapse of the New York Stock Exchange.

Among the provisions of SOX, which were mandatory for public companies in the North American capital market, the following items stand out: (i) the requirement to establish an Audit Committee with powers to set policies regarding audit hiring; (ii) mandatory rotation of audit partners every five years; (iii) limitations on non-audit services provided by auditors to their audit clients; (iv) the requirement for audit engagement by the Audit Committee, which oversees the services provided and analyzes work that could create conflicts of interest (Gramling et al., 2012. p. 41-42).

Regarding non-audit services provided by auditors to their clients, Section 201 of SOX (2002) establishes services outside the scope of audit practice. Therefore, North American accounting firms are prohibited from providing, alongside audit services, other services that include:

- (i) bookkeeping or other services related to accounting records or financial statements of the audit client;
- (ii) financial information systems design and implementation;
- (iii) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (iv) actuarial services;
- (v) internal audit outsourcing services;
- (vi) management functions or human resources;
- (vii) broker or dealer, investment advisor, or investment banking services;
- (viii) legal services and expert services unrelated to auditing; and
- (ix) any other service that the Board determines, by regulation, is impermissible. (Sox, Seção 201. 2022).

It's worth noting that in December 2019 the SEC began a movement to amend regulations regarding services provided by auditors. After ten months of study, in 2020 the SEC amended Rule 2-01 of Regulation S-X, which deals with the employment relationships between external auditors and their clients, introducing a new concept of affiliate of the audit client. As a result, auditors have seen an increase in their services as new clients, resulting from relationships with affiliates, may also use their services (Mintz, 2020).

2.2 Previous studies on conflicts of interest in auditing financial statements

In terms of potential conflicts of interest, both national and international literature on the hiring of independent auditors discusses issues related to the following topics: (i) independence regarding the length of the relationship between auditor and auditee; (ii) the relationship between

fees for non-audit services and the quality of financial reports; (iii) stakeholders' perceptions of various types of services provided by external auditors in organizations; and (iv) Management and Independent Audit Reports.

Some studies have aimed to analyze the auditor's independence based on the length of the relationship with the client. Johnson et al. (2002), for instance, conducted a study examining the performance of six major audit firms in the North American market and the implications of these engagements, which ranged from two to over nine years in duration. In general, the authors argued that reports from audit firms with shorter client relationships have lower quality, contributing to the discussion on audit firm rotation among their clients (Johnson et al., 2002).

In turn, Cahan et al. (2008) investigated whether the independence of New Zealand auditors is affected by long-term relationships, considering the period from 1996 to 2001. The results indicated, overall, that there is no influence of non-audit service fees on auditor independence in managing earnings over the period.

Notably, research results are divergent Johnson et al. (2002) concluded that reports from audit firms with shorter client relationships are of inferior quality, whereas Cahan et al. (2008) suggest a lack of evidence regarding the relationship duration between the client and the audit firm affecting the quality of work.

A second line of study examines the relationship between spending on non-audit services and the quality of financial reports. In an analysis based on the North American market, albeit in different periods, Bloomfield and Shackman (2008) detected a negative influence of spending on non-audit services on the quality of financial reports, whereas Ghosh et al. (2009) indicate that there is no evidence of a relationship between non-audit service fees and auditor independence.

Nardi et al. (2020) analyzed the relationship between future fees for non-audit services and the quality of audit services in Brazilian publicly traded companies from 2010 to 2015. The authors argue that regulatory bodies should be vigilant as independence is linked to both audit quality and the provision of additional services. They did not identify an analysis of the specific types of additional services being provided by entities in the Brazilian market, considering the list of prohibited services outlined in specific regulatory instructions (Nardi et al., 2020).

Wahab et al. (2014) identified a positive relationship between audit fees and audit quality improvement, leading to enhanced quality of financial reports in a study conducted in Malaysia from 2007 to 2009 encompassing 953 observations. Following the revision of the Corporate Governance Code in 2012 which aimed to safeguard auditor independence compromised by non-audit services, Kamarudin et al. (2019) continued their studies on Malaysian companies, analyzing 706 firms listed on Bursa Malaysia in 2014. The results of this subsequent research reinforce the idea that knowledge gained from providing such services tends to enhance audit performance, thereby improving financial reporting. However, to ensure independence is not in doubt, it is crucial that issued reports reflect adopted policies, addressing concerns that may arise among users of financial statements.

Erik et al. (2021) examined the quality of audit services in the North American market based on the period from 2005 to 2015. The authors found that emphasizing non-audit services led companies to conduct audits of lower quality. The results suggest that when non-audit services are contracted, audit quality tends to be inferior, potentially indicating audit failures as well (Erik et al., 2021).

Perception among various stakeholders constitutes a third line of research. Based on a questionnaire involving 468 respondents including accountants, financial managers, and internal auditors of Pakistani companies, Ramzan et al. (2020) assessed the potential impact of non-audit services on auditor independence. The authors identified that there was no consensus regarding the influence of non-audit services (Ramzan et al., 2020).

In a study by Meuwissen and Quick (2019), members of the Supervisory Board of German companies were surveyed about auditor independence when providing both audit and non-audit services. The research suggests that providing non-audit services has a negative effect on the independence of external auditors, signaling the need for discussions in the European market, which maintains an extensive list of prohibited services (Meuwissen & Quick, 2019).

Oliveira (2020) analyzed the perceptions of a group comprising 56 Certified Auditors and 22 stakeholders regarding the impact of non-audit services in Portugal. The study results indicate that some additional services, such as consulting and internal control, compromise auditor independence to a greater extent (Oliveira, 2020).

Based on a dataset covering 86% of employees from major accounting firms in the USA, Fedyk et al. (2023) found that the knowledge gained by consulting teams tends to enhance the quality of audit services. These findings contribute to the expansion of studies on the segregation of duties in various areas that may generate conflicts of interest when such services are provided to the same client (Fedyk et al., 2023).

In the research line related to the analysis of Management Reports, three studies stand out. Ponte and Oliveira (2004) conducted a content analysis of Management Reports and Explanatory Notes from 95 companies for the fiscal year ended in 2002. In their study, there was no mention of the hiring of audit services, suggesting that up until that point, regulatory bodies had not shown concern regarding the oversight of non-audit services provided by audit firms, despite the existence of Instruction Normative No. 308 issued in 1999 (Ponte e Oliveira, 2004).

Gallon et al. (2008) investigated how 58 companies participating in the Governance Levels and New Market of the Brazilian stock exchange were disclosing information to meet specific requirements from CVM. The study pointed to a greater concern in disclosing financial data, even in non-traditional accounting reports such as the Management Report (Gallon et al., 2008). The research highlighted that details about the relationship with auditors were found in 9.83% of the analyzed reports. Interestingly, there was no mention of CVM Instruction No. 381 in the research findings, which was in effect at the time and pertained to companies disclosing their relationship with external auditors.

Silva and Silva (2017) analyzed the quality of disclosure regarding services provided by independent auditors in Brazil. They examined 374 companies registered with CVM and found that only 95 of them disclosed information about other services provided, while 214 companies indicated that they did not engage in such services in the fiscal year 2015. Among the companies that disclosed information about their relationship with auditors, 77 out of the 95 companies mentioned their policies to avoid conflicts of interest.

In Silva and Silva's study (2017), it is identified that some Brazilian companies may be providing services prohibited by legislation, such as those related to information systems and internal controls, as well as accounting and tax consulting. The research findings support the concerns raised by Mintz (2020), suggesting that some audit firms may not be adhering to the regulations of their respective regulatory bodies regarding the provision of non-audit services to their audit clients, whether intentionally or due to a misunderstanding of the current laws.

Overall, the studies were inconclusive regarding the influence of services provided on the independence of external auditors across the four analyzed research lines. In Brazil, despite some studies using the Management Report as a reference, they provide superficial analyses and identify little concern in complying with regulatory requirements. Moreover, no research was found in the reviewed literature that was based on Policies for Hiring Non-Audit Services by Independent Auditors.

3 METHODOLOGY

To fulfill the objective of this study, a content analysis was conducted based on the Management Report and the Policy for Hiring Non-Audit Services by their Independent Auditors, disclosed by the selected companies in the sample (Pletsch et al., 2021).

The sample selection was based on the list of public companies with CVM for the fiscal year 2020, as it was the latest available for consultation at the time of this study's preparation. The research sample consists of 377 Management Reports and 36 Policies for Hiring Non-Audit Services by their Independent Auditors.

The Management Report was individually researched on the CVM website using the identifier code for each registered company. Content analysis was conducted by searching for the keywords "381" and "auditor" supplemented by reading the respective reports in cases where terms were not identified, as some documents are sent in non-editable formats, making the use of search tools challenging. Data collection was done manually in May and September 2021.

The reports concerning the Policy for Hiring Non-Audit Services from Independent Auditors were obtained from the CVM website, under the section of Periodic and Eventual Information Sent to CVM. The selected category was "Policy for Hiring Non-Audit Services from Independent Auditors," with a search conducted for all companies that submitted the document in PDF format. Data collection was done in May 2022.

The composition of the research sample is indicated in Table 1.

Table 1

Composition of the research sample

	Number of companies	%
Panel A - Companies with reports disclosed on December 31, 2020		
Registered companies	385	
(-) Companies that did not disclose a report on December 31, 2020	<u>(8)</u>	
Total	377	
Panel B - Disclosure in the Management Report		
Companies that contracted other services and did not mention the adopted policy	13	4
Companies that contracted other services and mentioned the adopted policy	<u>91</u>	<u>24</u>
Subtotal of companies that contracted other audit services in 2020	104	28
Companies that did not include a note on the relationship with the auditor	84	22
Companies that reported no hiring of non-audit services	<u>189</u>	<u>50</u>
Total	377	100
Panel C - Disclosure of Policies for Hiring Non-Audit Services		
Companies that disclosed the Policy for Hiring Services	36	10
Companies that did not disclose the Policy for Hiring Services	<u>349</u>	<u>90</u>
Total number of registered companies	385	100

Notes. Companies that did not disclose reports on December 31, 2020: (a) Company without disclosure: one; (b) Company with closure in February 2021: one; (c) Companies with closure in March 2021: four; (d) Companies with closure in June 2021: two. Source: Self-prepared based on data identified on the website: www.cvm.gov.br.

Panel A of Table 1 presents the results of the survey data based on the Management Report. The latest version submitted by the companies was analyzed in cases where there were multiple submissions.

After a preliminary analysis of the Management Reports, four distinct information situations were identified, as detailed in Panel B of Table 1. This research focuses on analyzing companies that have engaged external auditors for services other than the audit of financial statements, totaling 104 reports.

Panel C of Table 1 presents the result of the survey data regarding companies that submitted to CVM their Policies for Hiring Non-Audit Services from their Independent Auditors, which were in effect in December 2020.

It is worth noting that the Management Report is mandatory for disclosure to the market, whereas the Policies for Hiring Non-Audit Services from their Independent Auditors are submitted to the CVM on an optional basis.

4 RESEARCH RESULTS

The results present an analysis of conflicts of interest from three perspectives. Initially, only the content of the Management Report is examined, followed by an analysis of the Policy for Hiring Non-Audit Services from Independent Auditors. Finally, the two main sources of information were compared to assess potential discrepancies between the datasets.

4.1 Analysis of the Management Report

The Management Report is a document that forms part of the communication between companies and their shareholders, investors, and stakeholders in general. Consequently, valuable information can be extracted from its contents. This research focuses on two main aspects of disclosure. Firstly, it examines whether there is mention of policies or procedures adopted to avoid conflicts of interest, loss of independence, or objectivity with auditors. Secondly, it analyzes the primary non-audit services contracted.

After analysis of the Management Reports, four groups were identified, in which the 104 companies that disclosed their respective service provision policies were allocated, as observed in Table 2:

Table 2

Identified situations regarding policy details in the Management Report

	Number of companies	%
Reports that did not mention the adopted policy	13	13
Reports that included standard text	41	39
Reports that used concise texts	24	23
Reports where the policy was more detailed	26	25
Total	104	100

Source: Own elaboration based on the content of the analyzed reports.

As detailed in Table 2 thirteen companies did not disclose any information about the adopted policy, accounting for 13% of the sample, although they disclose in the Management Report information regarding the hiring of additional services beyond those provided for auditing the financial statements. Notably, this group of companies did not comply with the requirements of Article 2 Section III of CVM Instruction No. 381/1999 regarding the disclosure of policies or procedures adopted by the company to prevent conflicts of interest, loss of independence, or objectivity of their independent auditors when performing any service other than external auditing.

Silva and Silva's study (2017), like this research, also identified deficiencies in the disclosure of information required by the Brazilian capital market regulator. Out of the 95 companies that hired non-audit services in 2015 eighteen did not include information in the Management Report about policies to prevent conflicts of interest, representing a percentage of 19% (Silva and Silva, 2017). However, there has been an improvement of approximately 6% in

the disclosure of information in the Management Report when comparing the periods of 2015 and 2020.

Furthermore, 41 companies, or 39% of the sample, disclose only standardized information. All texts indicated the three elements specified in item 58 of CFC Resolution No. 1.267/2009, which approved NBC PA 02 - Independence: "(a) the auditor should not audit their own work, (b) the auditor should not perform managerial functions in their client, and (c) the auditor should not promote the interests of their client" (CFC, 2009).

The use of standardized texts is not best practice, as it provides little information about the policies each company employs when hiring additional services beyond external auditing. These findings suggest a lack of concern from companies in detailing their reports, prioritizing financial data, as previously noted by Gallon et al. (2008), even in reports that are not strictly accounting-related, such as the Management Report. It is worth noting that literature suggests companies' management puts more effort into detailing contracted amounts, while less attention is given to describing procedures to be adopted when hiring non-audit services (Gallon et al., 2008).

In the third group analyzed, as highlighted in Table 2 there are 24 companies, accounting for 23% of the sample, that briefly mentioned the adopted policy. In some cases, this included only information stating that the company adheres to fundamental principles, such as the absence of conflicts of interest and independence. Additionally, it was found that some companies in this third group had hired non-audit services amounting to more than 100% in relation to external audit services.

Based on the value of service contracts, Bloomfield and Shackman (2008) suggest that there is an influence on the fees charged for non-audit services regarding auditor independence. Including more comprehensive information about the procedures adopted allows for a clear identification of the policy adopted, thereby avoiding questions related to conflicts of interest.

In the last group detailed in Table 2 which includes 26 companies, accounting for 25% of the sample, it is possible to clearly verify the adopted policy, thereby avoiding conflicts of interest, as these policies are more thoroughly detailed in their respective Management Reports. It is worth emphasizing that nine companies in this group also have their shares traded on the US stock exchange, and therefore, they adhere to stricter policies regarding the hiring of other services, especially following the enactment of the Sarbanes-Oxley Act (SOX).

Among the main policies adopted by the 26 companies analyzed, the following stand out: (i) detailed description of the contracting process; (ii) delegation to the internal bodies responsible for the hiring process of the auditor responsible for the execution of extra-audit services; (iii) adoption of a list with pre-approved extra-audit services; (iv) adoption of a list of prohibited extra-audit services; (v) periodic monitoring of ongoing services; and (vi) establishment of limits based on the fees of the contracted audit.

Another frequent question concerns the additional services provided by audit firms (Mintz, 2020). Table 3 presents the types of non-audit services contracted by 104 companies in 2020, as disclosed in the Management Report, compared to the data collected in 2015 by Silva and Silva (2017).

Table 3
Services contracted and disclosed in the Management Report.

Category of services	Type of service	2015 ¹		2020 ²	
		Qty	%	Qty	%
Advisory and Consulting	Tax Advisory/Consulting	29	18.9%	17	11.8%
	Labor and Social Security Advisory/Consulting	6	3.9%	2	1.4%
	Accounting Advisory/Consulting	4	2.6%	4	2.8%
	Information Systems Consulting	5	3.2%	5	3.5%
	Process Consulting	2	1.3%	0	0.0%
	Consulting Services	0	0.0%	2	1.4%
	Subtotal	46	29.9%	30	20.9%
Additional Accounting Reviews	Review of financial, tax, or actuarial information	40	26.1%	13	9.0%
	Regulatory statements	7	4.5%	6	4.2%
	Additional agreed-upon procedures	5	3.2%	12	8.3%
	Comfort letters issuance	3	2.0%	16	11.1%
	Internal control related procedures	2	1.3%	3	2.1%
	Specific regulatory body procedures	0	0.0%	2	1.4%
Subtotal	57	37.1%	52	36.1%	
Company acquisitions and public offerings	Operations abroad	7	4.5%	4	2.8%
	Issuance of appraisal reports	5	3.2%	5	3.5%
	Acquisition of new businesses	2	1.3%	4	2.8%
	Operations related to offerings and share certificates	0	0.0%	6	4.2%
	Due diligence	0	0.0%	13	8.9%
	Subtotal	14	9.0%	32	22.2%
Other services	Asset management report	7	4.5%	4	2.8%
	Sustainability report review	4	2.6%	4	2.8%
	Training	4	2.6%	0	0.0%
	Price and transfer pricing review	2	1.3%	0	0.0%
	Supply process diagnosis and improvement	2	1.3%	0	0.0%
	Lottery audit	2	1.3%	0	0.0%
	Information in administrative procedures	2	1.3%	0	0.0%
	Assurance report	0	0.0%	6	4.2%
	Compliance with financial covenants	0	0.0%	3	2.1%
	Forensic technology services	0	0.0%	2	1.4%
	Translation of reports into English	0	0.0%	2	1.4%
	Other services	14	9.1%	9	6.1%
	Subtotal	37	24.0%	30	20.8%
TOTAL		154	100.0%	144	100.0%

Notes. (a) Research based on the report of 95 companies that disclosed information about other services provided as of December 31, 2015; (b) Research based on the report of 83 companies that disclosed information about other services provided as of December 31, 2020.

Source: (1) Data from 2015 extracted from Silva and Silva's study (2017, p. 57); (2) Data from 2020 collected by the author based on the Management Reports included in the research.

In Table 3, it is possible to observe a concentration in the year 2020 on five main non-audit services:

- (1) Tax advisory/consulting (11.8%);
- (2) Comfort letters issuance (11.1%);
- (3) Review of financial, tax, or actuarial information (9%);
- (4) Due diligence (8.9%); e
- (5) Additional agreed-upon procedures (8.3%).

These services represent 49.1% of the total non-audit services contracted by the 83 companies during the period under analysis.

In the year 2015, the main services were: (1) Review of financial, tax, or actuarial information (26.1%) and (2) Tax advisory/consulting (18.9%).

In both years analyzed, there is a concentration on tasks related to "Tax Advisory/Consulting" and "Review of financial, tax, or actuarial information." The year 2015 was the most significant, representing 45% of the total contracted for just these two services, compared to 20.8% in 2020.

On the other hand, the year 2020 showed greater diversity, with the addition of services such as "Additional agreed-upon procedures" and "Comfort letters issuance," in addition to "Due Diligence," which had no recorded contracts in 2015.

Possibly, the category of "Advisory and Consulting Services," which accounts for 20.9% of the total non-audit services contracted in 2020 and 29.9% in 2015, may be the group that could generate more questions or scrutiny.

The CVM Instruction No. 308/1999 prohibits auditors from providing consulting services that may result in a loss of independence and objectivity, thereby potentially creating conflicts of interest between the auditing firm and its clients. Some market groups, such as Audit Committees and stakeholders, perceive that Advisory and Consulting Services impose a greater compromise on auditor integrity (Oliveira, 2020), which could negatively influence the relationship between the parties. Therefore, independent audit firms must implement procedures to avoid conflicts of interest in non-audit services. On the other hand, audit clients should have clear and detailed policies that the company must adopt.

It is worth noting that the category with the most frequent contracted services is "Additional Accounting Reviews," representing 36.1% of the total non-audit services contracted in the fiscal year. The services within this subgroup may directly relate to the audit work of financial statements, such as "Review of financial, tax, or actuarial information" and "Regulatory filings." In these cases, the knowledge gained through the provision of non-audit services can assist the audit team in improving the quality of their work, as suggested by Fedyk et al. (2023).

Certainly, services related to internal controls, classified in the second group of Table 3, likely deserve greater attention, especially when they are related to accounting data. Brazilian legislation highlights that services related to the redesign of internal control systems can lead to a loss of objectivity, while North American and European laws prohibit outsourcing of internal audit services. This issue is underscored by Mintz (2020), who found that some audit firms may not be fully compliant with these regulations due to misinterpretation or intentional actions. Therefore, a comprehensive description of the services provided, as disclosed in the Management Report, can assist users in assessing the potential for conflicts of interest.

The engagement of additional services alongside external auditing can create situations of conflict of interest. Therefore, companies should pay attention to detailing the purpose of the engagement, meaning the nature of the service, as well as its relevance compared to audit services. Only through more detailed analyses of the purpose of each contract can potential conflicts arising from the simultaneous provision of audit and non-audit services be identified.

4.2 Analysis of the Policy for Hiring Non-Audit Services from Independent Auditors

In general, it is observed that few companies disclose to the CVM their Policy for Hiring Non-Audit Services from Independent Auditors. This is mainly due to the non-mandatory requirement for submitting this report to the CVM, as well as the availability of submission mechanisms to the agency only since August 2018. Within the analyzed group, two companies stand out for not allowing the hiring of non-audit services under any circumstances, as per the evaluated document.

Based on the analysis of Policies, this research highlights aspects related to the competent body for contracting, the concentration of such services mainly within the big four firms, the services prohibited from being contracted, and the inclusion of established limits for contracts.

Table 4 presents the analysis of the Policy for Hiring Non-Audit Services by their Independent Auditors for 34 companies that disclosed it.

Table 4
Analysis of the policy for hiring non-audit services by their Independent Auditors

	Quantity	%
Panel A - Competence for hiring Non-Audit Services		
Audit Committee	21	62
Board of Directors	7	21
Fiscal Council	2	6
Others	4	11
Total	34	100
Panel B - Audit Firm Hired by Entities		
Ernest & Young	13	38
PWC	10	29
KPMG	7	21
Deloitte Touche Tohmatsu	3	9
Grant Thornton Brasil	1	3
Total	34	100

Note. Two companies were not included in the sample, as their policies do not allow the hiring of non-audit services under any circumstances. Source: Own elaboration based on the content of the analyzed reports.

The Panel A of Table 4 demonstrates competence for hiring by three main bodies, namely, Audit Committee, Board of Directors, and Fiscal Council.

It is noteworthy that in the majority of cases, or 62% of the sample, the competence for hiring is delegated to the Audit Committee, following a trend in North American legislation that requires the mandatory establishment of such a committee.

Among the 21 companies that detailed the delegation of hiring extra-audit services to the Audit Committee, as detailed in Panel A of Table 4, there are four companies with shares traded on the North American Stock Exchange. These companies are required to comply with specific legislation regarding the creation of an Audit Committee, as well as monitoring the services provided, and analyzing work that may generate conflicts of interest.

Delegating the hiring of extra-audit services to the Audit Committee and Boards provides clear oversight and enhances reliability in the contracting processes of companies. Even engagements that may lead to conflicts of interest are being scrutinized by key stakeholders within the company, ensuring that control mechanisms are in place to guarantee transparency and operational adequacy.

The profile of the audit firms contracted was detailed in Panel B of Table 4. There is a concentration among the largest audit firms, or big four, with Ernst & Young being contracted by 13 companies (or 38%) of those that disclosed their Policy for Hiring Non-Audit Services by their Independent Auditors on the CVM website. This is followed by PWC and KPMG with 10 and 7 engagements, respectively.

Despite there being no legal requirement in Brazilian legislation for the inclusion of a list of services in their Policies for Hiring Non-Audit Services by their Independent Auditors, some companies include a prior list of non-audit services whose provision is prohibited, as determined by the company's governance bodies.

Table 5 presents a list of non-audit services prohibited by companies in their respective policies.

Table 5
Key prohibited services

Category of services	Type of service	Number of records	%
Additional audit reviews	Bookkeeping or other services related to accounting records or financial statements.	12	7
	Remodeling of accounting, information, and internal control systems.	8	5
	Revaluation of assets.	8	5
	Determination of value for the purpose of creating provisions (including contingent or technical reserves).	5	4
	Determination of recoverable amount of assets.	4	2
	Issuance of reports for business combinations	4	2
Additional tax reviews	Legal services and specialized services not related to audit	10	6
	Tax planning	6	3
	Litigation support and expert services (judicial and extrajudicial)	6	3
	Preparation of Annual Income Tax Adjustment Statement for administrators	3	2
Management or Human Resources	Tax, fiscal, and parafiscal assistance services	3	2
	Functions exclusively within management's responsibility	7	4
	Recruitment and selection of candidates for managerial or executive positions	7	4
	Management or HR services	7	4
Others services	Any other service influencing management decisions	7	4
	Actuarial services	12	7
	Outsourcing of internal audit	12	7
	Planning / Implementation of Information Technology (IT) systems impacting financial reporting	11	6
	Business valuation	11	6
	Broker or distributor, consultant or investment banking services	8	5
	Organizational restructuring advisory	5	4
	Issuance of reports, opinions, or documents for non-monetary contribution	4	2
Others	11	6	
	Total	171	100

Notes. In the 'Others' group, the listed services were included either twice or once.
Source: Own elaboration based on the content of the analyzed reports.

From the 34 companies whose policies were analyzed, 13 (36%) detailed a list of prohibited services. These details go beyond those listed in CVM Instruction No. 308/1999 and include, for example, the non-engagement of internal audit services, which are expressly prohibited by U.S. legislation. There is also inclusion of services judged by companies as potentially generating conflicts of interest, in addition to those regulated in Brazil and the U.S., such as "Issuance of reports for business combinations" and "Tax, fiscal, and parafiscal assistance services," which had 4 and 3 records, respectively.

In the listing presented in Table 5, the five most frequently prohibited services stand out. Four of these are expressly prohibited by U.S. legislation, through SOX, and by Brazilian legislation, through CVM Instruction No. 308/1999: (i) Bookkeeping or other services related to the company's accounting records or financial statements; (ii) Actuarial services; (iii) Outsourcing of internal audit; and (iv) Planning/Implementation of IT systems impacting financial reports.

However, among the cases analyzed, six companies include percentage limits for hiring non-audit services in their Policies, as shown in Table 6:

Table 6
Limits established for the hiring of non-audit services.

Percentage of engagement	Companies
Limit of 5% of the total services contracted	Iguatemi and Jereissati
Limit of 20% of the total services contracted	Ambev and Itausa
Limit of 30% of the total services contracted	Anima and Cognia

Source: Own elaboration based on the content of the analyzed reports.

Brazilian legislation does not establish limits on the hiring of services, requiring only disclosure of contracted fees and their percentage relative to fees for external audit services when applicable.

In Table 6, it is noticeable that companies like Iguatemi and Jereissati are more stringent compared to others, allowing for a 5% engagement of services, while others allow between 20% and 30%. Apart from the companies listed in Table 6, two other companies, instead of setting engagement percentages, have outlined a pre-approved list of services and established reference values.

However, the analysis of the Policies for Hiring Non-Audit Services from their Independent Auditors allows for a more detailed profile of the policies and procedures adopted by Brazilian public companies to avoid conflicts of interest in independent audit work.

Among the main policies adopted based on the Policy for Hiring Non-Audit Services from their Independent Auditors, the following are noted: (i) Delegation to the Audit Committee, Board of Directors, or Fiscal Council for contracting;(ii) Selection of auditors from Big Four firms;(iii) Inclusion of a list of prohibited services that could create conflicts of interest between parties, notably including bookkeeping services, actuarial services, and internal audit;(iv) Establishment of formal limits on the hiring of non-audit services, based on the total amount spent on audit services.

Finally, it is important to emphasize the small number of companies that voluntarily disclose their Policy for Hiring Non-Audit Services. In this regard, if the regulatory body made the submission of this report mandatory for companies, users would have the possibility of accessing more detailed information, considering that the Management Report typically provides summarized or incomplete information, at best.

Comparison with other research findings is not possible, as this study is the only one analyzing the Policies for Hiring Non-Audit Services from Independent Auditors. Therefore, this work will enable future studies based on the Policy for Hiring Non-Audit Services from Independent Auditors to be correlated, evaluating, for example, the evolution of document submissions to regulatory bodies and the informational quality of these submissions, especially when compared to other mandatory filings.

4.3 Management Report versus Policy for Hiring Non-Audit Services

The analysis involved comparing the content of the Management Report with the Policy for Hiring Non-Audit Services for the 36 public companies that disclosed such policies.

Table 7
Contents of the analyzed reports

	Management Report			TOTAL
	They hired services in 2020	They did not hire any services in 2020.	They did not include a note about their relationship with the auditor.	
Policies for Hiring Non-Audit Services				
Detailed hiring policy, including prohibited services	8	4	1	13
Detailed hiring policy	3	6	1	10
Simplified policy	1	8	2	11
Policy prohibits hiring	=	<u>1</u>	<u>1</u>	<u>2</u>
Total	12	19	5	36
Policy not identified	92	170	79	341
Total overall	104	189	84	377

Source: Own elaboration based on the content of the analyzed reports.

Among the 36 identified Policies for Hiring Non-Audit Services, based on Table 7 and the Management Report, it was found that: (a) 12 policies (33%) pertain to companies that hired non-audit services in the year 2020; (b) 19 policies (53%) mentioned that they did not hire services in the year under review; and (c) 5 policies (14%) relate to companies that did not include a note about their relationship with the auditor.

Table 7 also highlights that 8 companies that hired services in 2020 detail a list of prohibited services beyond those required by Brazilian legislation in their Policy for Hiring Non-Audit Services.

Regarding prohibited services, the main difference between the companies that hired services in 2020 and the total number of companies that disclosed their detailed policy, as detailed in Tables 8 and 5 respectively, is the prohibition of internal audit services.

The main services contracted by the 8 companies that performed non-audit services in 2020 and included a list of services are listed in Table 8:

Table 8

The main prohibited services concerning the companies that hired services in 2020

	Quantity	%
Outsourcing of internal audit	8	8
Bookkeeping or other services related to accounting records or financial statements	7	7
Actuarial services	7	7
Business valuation	7	7
Planning/Implementation of IT systems impacting financial reporting	6	6
Legal services and specialized services unrelated to auditing	6	6
Brokerage or distribution, consultant, or investment banking services	5	5
Asset revaluation	5	5
Remodeling of accounting, information, and internal control system	5	5
Others	45	44
Total	101	100

Notes. Under the "Others" category, the remaining listed services were included. "TI" stands for Information Technology

Source: Own elaboration based on the content of the analyzed reports.

The comparison between the Management Report and the Policies for Hiring Non-Audit Services from their Independent Auditors allowed for analyzing potential discrepancies between two sources, which can, in fact, complement each other, thereby adding more information available to the market.

In the studies presented by Ponte and Oliveira (2004), Gallon et al. (2008), and Silva e Silva (2017), only the data included in the Management Reports were analyzed, mainly because the Policies for Hiring Non-Audit Services from Independent Auditors were not available during the period when these studies were conducted.

5 CONCLUSIONS

The present study analyzed the policies and procedures adopted to avoid conflicts of interest in Brazilian publicly traded companies that engage the same auditing firm to perform both the financial statement audit and other non-audit services. To achieve this objective, the Management Reports published by the companies for the fiscal year 2020 were examined, as well as the Policies for Hiring Non-Audit Services from their Independent Auditors in effect as of December 2020.

The analysis, based on 377 Management Reports, identified that 104 companies contracted non-audit services in addition to services related to the audit of financial statements for the year 2020. The research results suggest a lack of detailed information provided by the companies,

supporting findings from Gallon et al. (2008), which indicated a greater emphasis by companies on disclosing financial data.

The deficiency in disclosing information in the Management Report may also be related to how companies interpret the current legislation in the capital markets. For instance, the Policy for Hiring Independent Audit Services of one of the analyzed companies stipulates compliance with Instruction Normative No. 381/1999 only when non-audit services exceed 5% of the audit service fees.

Notably, the provision of certain services may raise concerns regarding conflicts of interest when contracted alongside external audit work. This research highlights the engagement of services such as (1) Tax advisory or consulting, (2) Issuance of comfort letters, and (3) Review of financial, tax, or actuarial information, accounting for 11.8%, 11.1%, and 9%, respectively, of services contracted in the fiscal year 2020. Therefore, it is important for companies to pay attention to detailing the scope of services, i.e., the nature of the service, in addition to their relevance compared to audit services. Furthermore, adopting clear policies and procedures is crucial to mitigate issues related to conflicts of interest within corporate organizations. Such information can be highly valuable for specific groups, including shareholders, suppliers, investors, and the capital markets.

The findings of this study, regarding the Management Report, are consistent with the studies by Meuwissen & Quick (2019) and Oliveira (2020), suggesting that consultancy-related services can generate conflicts of interest.

Among the main policies adopted, based on the Management Report, the following topics stand out:

- (i) detailed description of the contracting process;
- (ii) delegation to internal bodies responsible for contracting the auditor responsible for performing non-audit services;
- (iii) adoption of a list of pre-approved non-audit services;
- (iv) adoption of a list of prohibited non-audit services;
- (v) periodic monitoring of ongoing services; and
- (vi) establishment of limits based on contracted audit fees.

The analysis of the Policies for Hiring Non-Audit Services of their Independent Auditors identified allows for a more detailed profile of the policies and procedures adopted by Brazilian publicly traded companies to avoid conflicts of interest in independent audit work. As this is a more specific document, although not mandatory, it is desirable to include more details about the procedures adopted by companies to avoid conflicts of interest.

Based on the Policy for Hiring Non-Audit Services of their Independent Auditors, the main policies adopted are: (i) Delegation to the Audit Committee, Board of Directors, or Fiscal Council for hiring; (ii) Companies audited by the Big Four audit firms; (iii) Inclusion of a list of prohibited services, which may constitute conflicts of interest between the parties, with emphasis on services such as bookkeeping, actuarial services, and internal audit; (iv) Establishment of formal limits on the hiring of non-audit services, based on the total audit service fees.

The findings of this research also suggest that, despite CVM's requirement for disclosure in the Management Report of the policy and procedures adopted to prevent conflicts of interest in their work, as per CVM Instruction No. 381/1999, the regulatory body could further explore this disclosure among companies operating in the Brazilian market. Only with adequate disclosure, which can also occur spontaneously by companies, will stakeholders be able to obtain additional information regarding the processes adopted by each entity to avoid conflicts of interest in Brazilian companies when hiring external auditors for non-audit services.

This research advances compared to previous studies by analyzing the content of information in the Management Report regarding the relationship between companies and their

external auditors. Furthermore, the study is innovative as no literature has been identified that specifically analyzes Policies for Hiring Non-Audit Services from Independent Auditors.

As limitations, two aspects stand out. First, the qualitative content analysis reflects some subjectivity, primarily due to the researcher's judgment. Particularly, since the observation was based on non-standardized documents provided by the companies, the analyst's judgment becomes even more relevant.

Secondly, the data analyzed in this study pertain to the period of the Covid-19 pandemic, which began in March 2020. Therefore, the results of this research may have been influenced by this aspect, which requires special attention from the reader.

As a suggestion for future research, the study could extend the period of analysis, focusing on specific market segments or companies that are more actively traded on the stock exchange. Alternatively, it could delve into the policies adopted by companies complying with the Sarbanes-Oxley Act (SOX).

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CONFLICT OF INTEREST

The authors assert that there is no conflict of interest related to this submitted work.

AUTHOR CONTRIBUTIONS

Roles	1st author	2nd author
Conceptualization	◆	
Data curation	◆	
Formal analysis	◆	
Funding acquisition	◆	
Investigation	◆	
Methodology	◆	
Project administration	◆	
Resources		
Software		
Supervision		◆
Validation		◆
Visualization	◆	
Writing – original draft	◆	
Writing – review & editing		◆