College of Business and Economics

Department of Management

Distance Program

Factors Affecting Perceived Quality of Financial Statements Audit in Ethiopia: Implications for Managers of Ethiopian Businesses

A thesis submitted to Department of Management in partial fulfillment of the requirements for the award of a Master's Degree in Business Administration

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June, 2024

Addis Ababa, Ethiopia

DECLARATION

I, the undersigned, hereby declare that this work entitled "Factors Affecting Perceived Quality of Financial Statements Audit in Ethiopia: Implications for Managers of Ethiopian Businesses" is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person nor material which has been accepted for the award of any other degree or diploma of the university or other institute of higher learning, except where due acknowledgment has been made in the text.

Belete Tensaye  27/06/2024

Candidate's Name Signature Date

Advisor's Approval

This Thesis has been submitted for examination with my approval as an advisor.

Desalegn Amlaku (PhD)  28/06/2024

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ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

GRADUATE PROGRAM

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We, the undersigned, members of the Board of Examiners of the final open defense by Belete Tensaye have read and evaluated his thesis entitled, **"**Factors Affecting Perceived Quality of Financial Statements Audit in Ethiopia: Implications for Managers of Ethiopian Businesses" and examined the candidate. This is therefore to certify that the thesis has been accepted in partial fulfillment of the requirement of Degree of Master of Business Administration in Management.

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ACKNOWLEDGEMENTS

First of all, I thank the Almighty God for the wisdom and inspiration he provided to me required in all of my endeavors including this research. Nothing is possible without his will!

I would like to express my gratitude to many people who contributed in several ways to the successful completion of this research. Particularly, I thank my advisor, Dr. Desalegn Amlaku, whose valuable comments and counsel guided the entire work. My special thanks also go to all who participated in the study. They provided me with generous assistance in terms of sharing their precious time, knowledge, and the data I needed. This thesis could not have been completed without the assistance of all these people.

Finally, I would like to take this opportunity to express my heartfelt gratitude to my family and friends for their valuable support throughout my time working on this paper.

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LIST OF ACRONYMS AND ABBREVIATIONS

AABE	Accounting and Auditing Board of Ethiopia
ACCA	Association of Chartered Certified Accountants
ACSO	Authority for Civil Society Organizations
AEA	Association of External Auditors- Ethiopia
ASC	Audit Service Corporation
ASE	Accounting Society in Ethiopia
CIA	Certified Internal Auditor
CIMA	The Chartered Institute of Management Accountants
CPA	Certified Public Accountant
ECMA	Ethiopian Capital Market Authority
EPAAA	Ethiopian Professional Association of Accountants and Auditors
IAASB	International Auditing and Assurance Standards Board
IFAC	International Federation of Accountants
IFRSs	International Financial Reporting Standards ();
IFRSs for SMEs	International Financial Reporting Standards for Small and Medium Entities
IPSASs	International Public Sector Accounting Standards
ISA	International Standards on Auditing
ISQM	International Standard on Quality Management
MoR	Ministry of Revenue
MoTRI	Ministry of Trade and Regional Integration
NAS	Non Audit Services
OFAG	Office of the Federal Auditor General
PWC	PricewaterhouseCoopers LLP
SPSS	Statistical Packages for Social Sciences

Abstract

As a matter of fact, audit quality is of paramount importance to users of audited financial statements. The literature suggests that achieving audit quality is difficult because it requires the involvement of various stakeholders and is affected by different factors. The general objective of the study was therefore to investigate some of the factors affecting audit quality in Ethiopia. In light of this objective, the study used explanatory research design and a combination of quantitative and qualitative research approaches. Two sample groups: 108 private audit firm owners/partners and one official from the regulators and three leaders from professional associations of accountants and auditors in Ethiopia were selected using judgment sampling technique. Primary data were collected from these sample respondents through questionnaires. The collected data were analyzed through descriptive and inferential statistics using Statistical Package for the Social Sciences (SPSS). The results of the study emphasized that auditors' competency and audit fee have statistically significant and positive effect on audit quality while audit firms' size, audit regulation, audit time and litigation environment have statistically insignificant effect. Moreover, the results confirmed that the audit regulation in Ethiopia is ineffective. The results suggested that the auditors, AABE and all other stakeholders should play their roles in order to upgrade auditors' competency, ensure the fairness of audit fee set for each audit engagement and make the audit regulation effective with a view to enhancing audit quality.

Keywords: audit firms' size, auditors' competency, audit time, audit fee, audit regulation, litigation environment, quality of audit of the financial statements (audit quality), audit firms (auditors), International Standards on Auditing (ISA), International Auditing and Assurance Standards Board (IAASB)

CHAPTER ONE: INTRODUCTION

This chapter provides introduction to the thesis, it contains eight sections. Section 1.1 presents general information about the research topic and discusses how the study was initiated. Section 1.2 discusses the problems (factors affecting quality of the audit of financial statements) which the study addressed. Section 1.3 outlines the general and specific objectives which the study attempts to achieve. Section 1.4 describes the questions to be answered upon the achievement of the research objectives. Section 1.5 discusses the areas (concepts, variables, etc.) covered and the sources of data/information used by the study. Section 1.6 presents the importance of the study in terms of its contributions to all the stakeholders in the auditing profession/practice. Section 1.7 specifies the restrictions inherent to the study and that arise due to its scope. Finally, Section 1.8 presents the organization of the remainder of the thesis.

1.1. Background of the Study

Quality of the audit of financial statements has a paramount importance to intended users of the audited financial statements including audit firms (auditors). This can be best understood by referring to the statement of the International Auditing and Assurance Standards Board (IAASB) made about the purpose of the audit under ISA 200. According to ISA 200, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements (IAASB, 2022). This implies that the intended users rely on the information obtained from the audited financial statements in making operational, financial and other decisions which could have economic and social impacts.

In fact, the motives behind the audits of financial statements are the requirements of the intended users. These requirements can be classified in to three types: 1) Statutory requirement (Kristina, 2023; PwC, 2017); 2) Lenders'/Creditors' and/or customers' requirement (Kristina, 2023; PwC, 2017); and 3) Owners'/Shareholders' requirement (Owolabi et al., 2016; PwC, 2017). Statutory requirement: In many jurisdictions, there is a statutory requirement for entities such as publicly listed entities and charitable organizations to get their financial statements audited on annual basis. In the case of Ethiopia various governmental bodies such as the Accounting and Auditing Board of Ethiopia (AABE); Ministry of Revenue (MoR) and other Tax Authorities; the

Ethiopian Capital Market Authority (ECMA); and Authority for Civil Society Organizations (ACSO) require entities to present their annual audited financial statements for various purposes. Lenders'/Creditors' and/or customers' requirement: Most of the time lenders/creditors such as banks and/or suppliers of goods or providers of services require their clients to present their audited financial statements as part of fulfilling the criteria set to provide loans/credits and to participate in tenders announced by their customers. Owners'/Shareholders' requirement: This happens due to the separation of ownership and control whereby owners/shareholders appoint managers to manage/control their entities on their behalf (as explained under the agency theory). In this case, owners/shareholders want to know whether the management is running their entities in their best interest or not. To this effect, they hire an independent audit firm to audit the entity's financial statements prepared by the management with a view to obtaining assurance as to their correctness/fairness.

The statutory requirement attached to the audit of financial statements is also applicable to the audit firms. It is apparent that the audit firms are required to comply with the relevant laws and ethical requirements in conducting audits. Otherwise, they will not continue in business as non-compliance will result in cancellation of their licenses at least in the long run.

In Ethiopia, the statutory requirement for the audit of financial statements is believed to be reinforced with the involvement of AABE as a regulator. AABE has been established in December 2014 with the following powers and duties among others: a) to issue standards and directives relating to financial reporting and auditing and ensure compliance therewith; b) to conduct inquiry or investigation and impose administrative sanction in accordance with the provisions of the Proclamation where appropriate on public interest entities to enforce compliance with financial reporting and auditing standards; c) to set criteria to distinguish reporting entities as either public interest entities or small and medium enterprises and register them accordingly; d) to register and license public auditors; and e) to conduct inquiry or investigation and impose administrative sanction in accordance with the provisions of the Proclamation where appropriate on public auditors to enforce compliance with financial reporting and auditing standards (Federal Government of Ethiopia, 2014; Ethiopian Council of Ministers, 2014). As part of its powers and duties, AABE has issued a directive, Directive No.

AABE 804/2013 (AABE, 2021) concerned with reporting entities based on which it has distinguished and started registering reporting entities which shall submit to it their annual audited financial statements. Moreover, it has issued another directive, Directive No. AABE 805/2013 (AABE, 2021) concerned with accounting and auditing professionals based on which it has been and is registering, licensing and regulating certified and public auditors. Many business and non-profit making entities in Ethiopia which are categorized by ABBE as reporting entities and the certified and public auditors are required to comply with the provisions of the respective directives.

Audit firms are established as business entities to provide audit, audit related and other non-audit services, of which an audit of financial statements is a major and important part, to the entities that need the services. This means that, the audit firms, like all other business entities, have a financial objective of making profit by conducting audits of financial statements in addition to the statutory requirement discussed above. Therefore, audits of financial statements are beneficial to the audit firms as they are for the auditees and other users of the audited financial statements.

The audit firms could exist as business entities and continue making profits from the audit of financial statements only when they can conduct the audits without compromising audit quality or only when they can achieve audit quality. If audit firms can achieve audit quality, they can achieve the audit objective of providing audit opinion on the financial statements. According to IAASB, an audit firm is required to conduct the audit in accordance with the International Standards on Auditing (ISAs) and relevant ethical requirements to achieve the audit objective (IAASB, 2022). Though the responsibility for performing quality audits of financial statements rests with auditors, audit quality is best achieved where there is support from, and appropriate interactions among, participants (the stakeholders) in the financial reporting supply chain (IAASB, 2022; PwC, 2017).

These stakeholders include regulators (for example, AABE in the case of Ethiopia); the Board of Directors, management, other key staffs, audit committee, customers and lenders/ creditors of the auditees; and standard setters. The involvement of the participants is vital for the achievement of audit quality as they have their own unique contributions. For instance, the audit committee is

responsible for reviewing the auditor's performance while regulators and standard setters play a key role in the oversight of the audit profession and the monitoring of audit quality (PwC, 2017).

The issue of audit quality remains vital to public confidence in audit. According to the Association of Chartered Certified Accountants (ACCA), while there is evidence that audit quality has improved and continues to improve, concerns remain, both about those audits that fall below satisfactory standards and about the pace of improvement. As a result, there is a keen interest in initiatives to drive better audit quality (ACCA, 2018).

Based on the discussion made so far, it is important for all the stakeholders to know the factors affecting quality of the audit. To this effect, studies on quality of the audit of financial statements and related topics should be conducted in order to obtain relevant information from the practical world. Based on this background, the study titled ‘Factors Affecting Perceived Quality of Financial Statements Audit in Ethiopia: Implications for Managers of Ethiopian Businesses’ was proposed and conducted accordingly.

1.2. Statement of the Problem

Audit quality is a complex subject and there is no definition or analysis of it that has achieved universal recognition. It encompasses the key elements that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis (IAASB, 2022). It is frequently used in debates among stakeholders, in communications of regulators, standard setters, audit firms and others, and in research and policy setting (IAASB, 2022; Rajgopal et al., 2021).

Audit quality and perceptions of audit quality have become issues recently with audit failures and corporate collapses such as Enron and WorldCom and the ensuing investigations resulting in regulatory changes (Chemeda, 2016; Matthews, 2006). This means that there have been problems in quality of the audit of financial statements. According to IAASB, audit quality is likely to be achieved by an engagement team that: a) exhibited appropriate values, ethics and attitudes; b) was sufficiently knowledgeable and experienced and had sufficient time allocated to perform the audit work; c) applied a rigorous audit process and quality control procedures; d) provided useful and timely reports; and e) interacted appropriately with relevant stakeholders. It

is best achieved where there is support from, and appropriate interactions among, participants (the stakeholders) in the financial reporting supply chain (IAASB, 2022). This implies that achieving audit quality is very challenging mainly due to the following two reasons: 1) achieving it requires the involvement of various stakeholders; and 2) it could be affected by various factors.

Several empirical studies on factors affecting audit quality have been conducted globally. For instance, Al-Khaddash et al. (2013) pointed out a positive and significant correlation between audit quality and audit efficiency, the reputation of auditing office, audit fees, and the proficiency of auditor. Auditor's independence has a positive effect on audit quality (Rahmina and Agoes, 2014; Zef Arfiansyah, 2020); Sawan and Alsaqqa, 2013). Suyono (2012) stated that accountability is the dominant factor affecting audit quality. Audit firm's size affects audit quality (DeAngelo, 1981); O. Enofe et al., 2013; Al-Khaddash et al., 2013; Sawan and Alsaqqa, 2013). Audit firm tenure has a positive significant relationship with audit quality (Rohami et al., 2009; Siregar et al., 2012; O. Enofe et al., 2013). However, Rahmina and Agoes (2014) pointed out that audit tenure does not have a significant influence on audit quality.

There were also empirical studies on factors affecting audit quality conducted in Ethiopia. For instance, Gelaneh (2011) showed that long audit tenure increases audit quality. Leilina (2015) concluded that audit firm industry specialization, joint provision of audit and non-audit service and certified audit professionals ratio have significant effect on audit quality in Ethiopian manufacturing share companies, while audit firm tenure has little or no significance. Afesha (2015) found out that higher audit fees, big audit firms and bank size have positive significant effects on the external audit quality. Tsegaw (2017) found out that big audit firms, audit competence, industry specialization/industry expertise knowledge by auditors and reputed audit firms are associated with higher audit quality. The World Bank reported the following factors among others which have negative impact on the quality of audits in Ethiopia: a) absence of local professional accountancy qualifications or training for professional accountancy; b) lack of capacity in all regulatory institutions to deal with accounting and auditing matters; c) absence of a mechanism for providing assurance on the quality of work being conducted by auditors; d) absence of a strong accountancy professional body, with IFAC membership; e) size of audit firms. Most of the audit firms are sole practitioners which means that they cannot meet the

internal quality review requirements in international good practice, which require a second/concurring partner review; and f) the audit fees in the country being very low, mainly caused by a practice where most appointments for auditors are done through a bidding process, with little or no regard of professional expertise (World Bank, 2007). These have been also confirmed by Ayele (2019), Fekede (2015) and Beyene (2007).

However, the studies conducted in Ethiopia are considered few implying that the factors affecting audit quality were not studied well. Moreover, they have limitations in that they 1) did not address quality of the audit of financial statements in general instead they are either industry specific, example on commercial banks and manufacturing companies or variable specific in addition to focusing only on describing the state of natures of the determinant factors (e.g., Afesha, 2015; Kitata, 2016; Malela, 2020; Leilina, 2015; Gelaneh, 2011; Assaye, 2016); 2) did not gather data from the regulators who are considered major stakeholders and important source of information regarding audit quality (e.g., Afesha, 2015; Kitata, 2016; Malela, 2020); 3) did not conduct extensive review of the publications of the IAASB, the body considered the global standard setter for audit and audit related services, for theoretical review purposes (e.g., Afesha, 2015; Kitata, 2016; Assaye, 2016); and 4) identify the implications for business managers of quality of the audit of financial statements and provide recommendations as to what they should do (e.g., Leilina, 2015; Gelaneh, 2011; Assaye, 2016).

These gaps should be addressed as doing so will support the key decision faced regarding the factors affecting quality of the audit of financial statements in Ethiopia- the steps that could be taken to effectively improve the quality of the audit. Therefore, the study attempted to fill the gaps. It aimed to contribute to the audit profession (audit theory and practice) in the understanding of factors affecting perceived quality of the audit of financial statements in Ethiopia and the implications for business managers.

1.3. Objectives of the Study

In light of the problems discussed above, the following general and specific objectives which the study is going to achieve are outlined.

1.3.1. General objective

The general objective of the study was to explore the major factors that affect perceived quality of the audit of financial statements in Ethiopia.

1.3.2. Specific objectives

In addressing the general objective, the following were the specific objectives of the thesis:

1. To examine the effect of audit firms' size on perceived quality of the audit of financial statements;
2. To examine the effect of auditors' competency on perceived quality of the audit of financial statements;
3. To examine the effect of audit time on perceived quality of the audit of financial statements;
4. To examine the effect of audit fee on perceived quality of the audit of financial statements;
5. To examine the effect of audit regulation on perceived quality of the audit of financial statements; and
6. To examine the effect of litigation environment on perceived quality of the audit of financial statements.

1.4. Research Questions

To achieve the objectives of the study the following research questions are developed:

RQ1: What is the effect of audit firms' size on perceived quality of the audit of financial statements?

RQ2: What is the effect of auditors' competency on perceived quality of the audit of financial statements?

RQ3: What is the effect of audit time on perceived quality of the audit of financial statements?

RQ4: What is the effect of audit fee on perceived quality of the audit of financial statements?

RQ5: What is the effect of audit regulation on perceived quality of the audit of financial statements?

RQ6: What is the effect of litigation environment on perceived quality of the audit of financial statements?

1.5. Scope of the Study

The study encompasses factors affecting perceived quality of the audit of financial statements in Ethiopia. The term 'audit' and 'auditors' in the study refer only to external audit and external auditors respectively. Unless otherwise specified wherever necessary, the International Standards on Auditing (ISAs) issued by International Auditing and Assurance Standards Board (IAASB) are the only audit standards referred to in the study as criteria for the audits of financial statements as they are allowed to be adopted in Ethiopia (Federal Government of Ethiopia, 2014). Similarly, the Framework for Audit Quality and the International Standards on Quality Management are the only frame work and standards for audit quality referred to in the study and used as source of data/information as they are issued by IAASB and by implication they are allowed to be adopted in Ethiopia. The other legal and regulatory; and ethical requirements applicable for the purpose of the study are specifically mentioned wherever necessary.

The financial statements referred in the study are a complete set of financial statements which are prepared using suitable financial reporting frameworks adopted in Ethiopia. These reporting frameworks are: International Financial Reporting Standards (IFRSs); International Financial Reporting Standards for Small and Medium Entities (IFRSs for SMEs); and International Public Sector Accounting Standards (IPSASs) (Federal Government of Ethiopia, 2014; AABE, 2021).

The views of both men and women partners/owners of private audit firms in Ethiopia, top level management staff of AABE, and leaders of the Ethiopian professional associations of accountants and auditors only were sought as they are considered most advantageously placed or in the best position to provide the information required. This is discussed further in Chapter 3.

Based on the conceptual framework, the factors which would be emphasized were audit firms' size, auditors' competency, audit time, audit fee, audit regulation and litigation environment. The study was not restricted by time frame as the data collected were about factors affecting audit quality which exist anytime with the existence of audit practice.

1.6. Significance of the Study

From the discussions made so far, it can be concluded that audit quality is achieved when an audit is conducted in accordance with the relevant audit standards such as ISAs including other relevant legal and ethical requirements. Upon achieving the objectives of the study described under section 1.3 above, the author/researcher believes that the study is considered timely and has the following significance:

a) It will serve as source of information to auditors and other stakeholders/ intended users of the audited financial statements about the factors affecting audit quality so that they can use the information in resolving the problems of audit quality and hence enhancing it which in turn leads to increase in the level of confidence of the intended users in the financial statements;
b) It will serve as source of information to business managers about the implications of perceived quality of the audit of financial statements for them and the respective measures they should take;
c) It will contribute knowledge to the audit profession (audit theory and practice) in the field of audit of financial statements in Ethiopia;
d) It may motivate researchers for further studies on audit quality in Ethiopia; and
e) It may serve as a reference for future researches on audit quality and other related researches.

1.7. Limitations of the Study

Despite its several contributions, the study suffers from some unavoidable limitations. It used mainly latent constructs (concepts) that cannot be directly observed or measured, but are assumed to exist based on other observable or measurable data or can be estimated through proxy measures. Consequently, both the structured and unstructured questionnaire methods used

in the study in measuring such constructs have unavoidable inherent limitations. The assumption connected with the measurement theory is another limitation. The hypotheses are based on the classical measurement theory. The classical measurement theory assumes that variations in the measures are a function of the true scores plus error and that the items under the latent variables do not share a common source of errors (Mihret, 2010). Moreover, the study cannot address all the factors affecting quality of the audit of financial statements because they are enormous. Rather, it focuses on the factors considered to have major impact on quality of the audit. Therefore, the results of the study need to be interpreted in view of these assumptions inherent in the measurement approach.

The study used judgment sampling which may curtail the generalizability of the findings, due to the fact that samples of auditors who are conveniently available are to be used. This may be considered another limitation. However, it is the only viable sampling method for obtaining the type of information that is required from very specific pockets of people who alone possess and can give the information sought. Judgment sampling calls for special efforts to locate and gain access to the individuals who do have the requisite information.

The study used a combination of quantitative and qualitative research approaches. Moreover, the country context, the audit practice being under development and the nature of the measurement to be employed for the statistical tests have their own impact on the study. Therefore, there is a need for flexibility while interpreting the results of the study.

1.8. Organization of the Study

The paper is organized into five chapters. Chapter one presents introduction of the study. Chapter two sets the scene for the thesis by providing a review of the theoretical and empirical literature related to the audit of financial statements, factors affecting quality of the audit, conceptual framework of the study and testable hypotheses. Chapter 3 provides information about the research design and methodology. Chapter 4 presents the data analysis, presentation and discussions of the results of the study. Finally, conclusions and recommendations are provided in Chapter five based on the findings of the study.

CHAPTER TWO: LITERATURE REVIEW

It is expected that the primary concern of audit firms/auditors and all other stakeholders regarding the audit of financial statements is its quality. When auditors achieve the audit objective, they are in a position to achieve audit quality and meet the interests of all other users of the audited financial statements/stakeholders. In this regard, it is apparent that the auditors and business managers as one of the users of audited financial statements are concerned about the factors affecting perceived audit quality, which warrant empirical studies. The purpose of this literature review is therefore to obtain information about the subject of the study from the theoretical literature and empirical studies with a view to having a better understanding about the subject and identifying the knowledge gap.

This chapter presents: a theoretical review of the literature on the audit of financial statements and related matters; review of empirical studies on factors affecting quality of the audit of financial statements; conceptual framework; and conclusion.

2.1. Theoretical Review

2.1.1. Brief history of auditing; definition and purposes of the audit of financial statements

The history of auditing goes back to 500-300 BC at the time of which some form of auditing (verification process) has been conducted in Greece (Costouros, 1978). According to Kumar and Mohan (2015), auditing evolved and grew rapidly after the industrial revolution in the 18th century with the growth of the joint stock companies and the separation of ownership and management. In Ethiopia the history of auditing goes back to the 1930s with the establishment of the Ethiopian Supreme Audit Institution (SAI) to provide accurate information to the legislative as to whether the executive body properly implemented the approved budget and other planned issues or not (OFAG, 2023; Beyashe, 2008).

Financial statement audits provide assurance that the statements fairly present the financial position of a company. This assurance is very meaningful for external parties that rely on the financial statements, such as investors, lenders, suppliers and even some customers (Kristina,

2023). PwC points out that an audit underpins the trust and obligation of stewardship between those who manage a company and those who own it or otherwise have a need for a ‘true and fair’ view (PwC, 2017). An audit enhances the credibility of financial reporting and potentially leads to improvement in the quality of financial reporting (IAASB, 2022).

In conducting an audit of financial statements, the overall objectives of the auditor are: a) to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and b) to report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor’s findings (IAASB, 2022).

2.1.2. Audit report and audit opinion

The audit report is the means through which the audit firm/auditor formally communicates the results of the audit of financial statements by expressing an audit opinion. According to ISA 700 (Revised) - Forming an Opinion and Reporting on Financial Statements, the auditor’s report shall be in writing. It shall contain the following items among others: a) a title that clearly indicates that it is the report of an independent auditor; b) an addressee; c) auditor’s opinion; d) basis for opinion; e) signature of the auditor; and f) date of the auditor’s report (IAASB, 2022).

The audit opinion is a key part of the audit report. It states the auditor’s conclusion on whether the financial statements, including disclosures are presented fairly in all material respects in accordance with the applicable financial reporting standards. The audit opinion can be ‘unmodified/clean’ or ‘modified’. A modified opinion could be: a qualified opinion, an adverse opinion; and a disclaimer of opinion (PwC, 2017; IAASB, 2022).

2.1.3. Users of audited financial statements

As a matter of fact, financial statements are used to make informed financial, operational and other decisions which could have economic and social impacts. As an audit of financial statements enhances the degree of confidence of intended users in the financial statements

(IAASB, 2022), they use the audited financial statements reliably. The following paragraphs present the major users of the audited financial statements along with the purposes why they need to use them.

It is obvious that governmental bodies use the audited financial statements of entities as one of the criteria to be met to get the services they provide to the entities or as means of ensuring the implementation of the provisions of the laws they enacted. According to IAASB, in the case of a public sector entity, legislators and regulators are often the primary users of its financial statements (IAASB, 2022). In the case of Ethiopia, for example reporting entities (business and non-profit making entities) are required to present their annual audited financial statements to AABE (AABE, 2021).

Owners/Shareholders want to ensure that their entities are operating to their best interests. To this effect they use financial and non-financial information obtained from the audited financial statements to know for instance about the profitability and liquidity position of their entities. They can get this information from the unaudited financial statements prepared by the management (the agent) on behalf of them (the principal) (as pointed out in the agency theory). However, it is more likely than not that the management may manipulate the financial statements to meet their own interests, for instance to maximize compensation based on performance. Therefore, the owners/shareholders would like to get the financial statements audited by an independent auditor to ensure their fairness/correctness and use them accordingly for the purposes mentioned above among others (PwC, 2017; Kristina, 2023; IAASB, 2022).

Lenders such as banks and creditors make sure that whether or not the entity they are going to lend or grant credit is capable of paying back the loan or settle the credit. One major reliable source of information for them is the audited financial statements of the entity, which report whether or not the financial statements fairly present, in all material respects the entity’s financial position and performance (PwC, 2017; Kristina, 2023).

Potential investors considering buying a company's shares want to ensure that the company is profitable and can continue in business for the foreseeable future. They can do this reliably by referring to the financial and non-financial information contained in the audited financial statements (PwC, 2017; Kristina, 2023).

2.1.4. Factors affecting quality of the audit of financial statements and management of audit quality

This section solely depends on the IAASB's publications- IAASB's frame work for audit quality (IAASB, 2022), the International Standard on Quality Management (ISQM) 1 (IAASB, 2020), ISQM 2 (IAASB, 2020), ISA 220 (Revised) (IAASB, 2022) and ISA 300 (IAASB, 2022) as IAASB is the global body responsible for the quality framework and standards and such frame work and standards are adopted in Ethiopia (Federal Government of Ethiopia, 2014; Ethiopian Council of Ministers, 2014; AABE, 2021).

According to IAASB's frame work for audit quality, auditors are required to comply with relevant auditing standards and standards of quality control for audit firms, as well as ethics and other regulatory requirements. Detailed consideration will need to be given to matters such as the nature, timing and extent of audit evidence obtained in response to the risks of material misstatement in a particular entity, the appropriateness of the relevant audit judgments made, and compliance with relevant standards. The Framework distinguishes the following elements of audit quality each of which incorporate several factors affecting audit quality: (a) Inputs; (b) Process; (c) Outputs; (d) Key Interactions within the Financial Reporting Supply Chain; and (e) Contextual Factors (IAASB, 2022).

Inputs: The input factors which affect audit quality are a) the values, ethics and attitudes of auditors; and b) the knowledge, skills, and experience of auditors and the time allocated for them to perform the audit. Within these input factors, quality attributes are further organized between those that apply directly at: a) the audit engagement level; b) the level of an audit firm; and c) the national (or jurisdictional) level (IAASB, 2022).

Process: Quality audits involve auditors applying a rigorous audit process and quality control procedures that comply with laws, regulations and applicable standards. For instance at the engagement level**,** audits need to be performed in accordance with auditing standards and are subject to the audit firm's quality control procedures, which comply with ISQM 1 (previously ISQC 1). These provide the foundation for a disciplined approach to risk assessment, planning, performing audit procedures and ultimately forming and expressing an opinion (IAASB, 2022).

Outputs: Outputs include reports and information that are formally prepared and presented by one party to another, as well as outputs that arise from the auditing process that are generally not visible to those outside the audited organization. For example, these may include improvements to the entity's financial reporting practices and internal control over financial reporting, that may result from auditor findings. The outputs from the audit are often determined by the context, including legislative requirements. Different stakeholders receive different outputs from an audit. These outputs are likely to be evaluated in terms of their usefulness and timeliness, and be seen as aspects of audit quality. Relevant outputs for instance at the Engagement Level may include**:** (a) **From the Auditor:** i) Auditor's Reports to Users of Audited Financial Statements; ii) Auditor's Reports to Those Charged with Governance; iii) Auditor's Reports to Management; and iv) Auditor's Reports to Financial and Prudential Regulators. (b) **From the Entity:** The Audited Financial Statements and Reports from Those Charged with Governance, including Audit Committees (IAASB, 2022).

Key Interactions within the Financial Reporting Supply Chain: Each separate stakeholder role and the way in which they interact in the financial reporting supply chain are important in supporting high-quality financial reporting and can have particular impact on audit quality. These interactions, including both formal and informal communications, will be influenced by the context in which the audit is performed and allow a dynamic relationship to exist between inputs and outputs. The one-to-one interactions with regard to audit quality include interactions between a) auditors and management, b) auditors and those charged with governance, (c) auditors and regulators and d) management and those charged with governance (IAASB, 2022).

Contextual Factors: There are a number of contextual (environmental) factors such as corporate governance; audit regulation; litigation environment; information systems; and financial

reporting timetable which have the potential to impact the nature and quality of financial reporting and audit quality. The environment in which financial reporting and audit take place varies among countries (IAASB, 2022).

According to ISQM 1, a firm which performs audits should have a system of quality management that operate in a continual and iterative manner and be responsive to changes in the nature and circumstances of the firm and its engagements. The system should address the following components among others: (a) The firm's risk assessment process; (b) Governance and leadership; (c) Relevant ethical requirements; (d) Resources; and (e) Information and communication. The individual(s) assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, should ensure whether the system of quality management provides the firm with reasonable assurance that the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements (IAASB, 2020).

According to ISQM 2, a firm which performs audits is required to appoint an engagement quality reviewer(s). An engagement quality review is an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report. The firm shall establish policies or procedures that a) require the assignment of responsibility for the appointment of engagement quality reviewers to an individual(s) with the competence, capabilities and appropriate authority within the firm to fulfill the responsibility, and b) set forth the criteria for eligibility to be appointed as an engagement quality reviewer (IAASB, 2020).

2.1.5. Implications of factors affecting audit quality and the audit quality for business managers

Business managers are one of the major users of audited financial statements. Management, like some other stakeholders, has more direct insights into some of the inputs to audit quality and are therefore better placed to evaluate it, at least in part (IAASB, 2022). Therefore, these factors, such as audit firms' size, auditors' competence and audit fee, affecting audit quality have

implications for them. This means that they need to consider these factors while appointing auditors and communicating with them during the audit process.

Audit quality has several implications for business managers. According to IAASB, management may particularly value a) insights into, and recommendations for improvement in, particular areas of the entity's business and systems; b) observations on regulatory matters; and c) global perspectives on significant industry issues or trends. An open and constructive relationship between auditors and management also helps create an environment in which management can benefit from auditors' observations on matters such as: a) possible improvements to the entity's financial reporting practices; b) possible improvements in internal control over financial reporting; c) new financial reporting requirements; d) perspectives on industry issues' and e) observations on legal and regulatory matters (IAASB, 2022).

2.2. Empirical Studies on Factors Affecting Quality of the Audit of Financial Statements

The review of the theoretical literature presented in section 2.1 above pointed out that quality of the audit of financial statements is the concern of various stakeholders such as regulators; owners, lenders/creditors, suppliers and customers of the auditees; and investors. It points out that the stakeholders have their own important roles to play towards the achievement of audit quality. It also discusses the several factors that affect audit quality and which need to be addressed accordingly.

As part of achieving the purpose of the literature review mentioned above, it is important to obtain information about factors affecting audit quality from empirical studies in support of the theoretical views. As the empirical studies obtain information from the practical world, they are considered good source of information. Hence, the purpose of this empirical review is to gather such information from past studies on factors affecting audit quality.

There are many studies on the subject conducted globally and in Ethiopia. For the purpose of the study, the researcher selected those which are considered more relevant taking the problem which the study is going to deal with and the objectives of the study into consideration. The review of the studies is presented in the following paragraphs in two separate sub-sections. The

first section for the studies conducted globally and the second one for studies conducted in Ethiopia.

2.2.1. Studies conducted globally

According to DeAngelo (1981), ceteris paribus, the larger the auditor as measured by the number of current clients and the smaller the client as a fraction of the auditor's total quasi-rents, the less incentive the auditor has to behave opportunistically, and the higher the perceived quality of the audit. She argued that auditor's size matters on audit quality.

Rohami et al. (2009) researched on "audit firm tenure and auditor reporting quality: evidence in Malaysia" by employing well-established going concern model of logistic regression. Their findings show that audit firm tenure has a positive significant relationship with auditor reporting quality.

Suyono (2012) studied on "Determinant Factors Affecting the Audit Quality: An Indonesian Perspective". The results of the study show that: 1) independence, experience and accountability affected audit quality simultaneously; 2) independence and accountability affected audit quality partially, meanwhile experience did not affect audit quality partially; and 3) accountability was the dominant factor affecting audit quality.

Adeyemi et al. (2012), in their study entitled "Factors affecting audit quality in Nigeria", used both primary data supplied by 430 respondents and secondary data generated from the financial statements of forty annual reports of companies quoted on the Nigerian Stock Exchange and pointed out that among others, multiple directorship is the most significant factor in affecting audit quality and provision of non-audit service would likely have a significant effect on the audit quality in Nigeria.

Siregar et al. (2012) studied on "Audit Tenure, Auditor Rotation, and Audit Quality: The Case of Indonesia". The results of their study do not support that mandatory auditor rotation increases audit quality or that a shorter audit tenure (both partner and firm level) increases audit quality.

Joshua et al. (2013) studied on “Audit Firm Reputation and Audit Quality” using a sample of listed companies trading on the floor of the Nigerian Stock Exchange and their findings showed that there is a positive significant relationship between audit firm reputation and audit quality.

Enofe et al. (2013), in their study “Determinants of Audit Quality in the Nigerian Business Environment”, stated that audit firm size, board independence and ownership structure were found to be positively related to audit quality; however, only board independence exhibited a significant relationship with audit quality. Audit tenure exhibited a negative relationship with audit quality which was also not significant.

Al-Khaddash et al. (2013) researched on “Factors affecting the quality of Auditing: The Case of Jordanian Commercial Banks**”**. They have investigated the perceptions of Jordanian Commercial Banks (JCBs) internal and external auditors in addition to financial managers. The results of their study indicated a positive and significant correlation between audit quality and audit efficiency, the reputation of auditing office, auditing fees, the size of audit firm, and the proficiency of auditor.

Sawan and Alsaqqa (2013) studied on “Audit firm size and quality: Does audit firm size influence audit quality in the Libyan oil industry?” using questionnaires and interviews and concluded that audit size is positively related to audit quality and the quality of the audit of the big four audit firms in Libya was higher as those firms were reported to be more powerful, effective and independent than the non-Big four firms as they have more incentive to protect their reputation and continue with their high earnings.

In their study of the drivers of audit quality, Alan et al. (2014) pointed out that audit firm size, partner/manager attention to audit, provision of non-audit services, partner knowledgeable about client industry and communication between audit team and client management considered relatively important by the CFO respondents in order of importance. The attributes considered least important are audit quality assurance review and audit partner tenure.

Rahmina and Agoes (2014) made a research on the effect of auditor independence, audit tenure, and audit fee on audit quality in Indonesia through questionnaires completed by external auditors

in Jakarta, Indonesia. Their study shows that audit independence has a positive effect on audit quality while audit tenure does not have a significant influence on audit quality.

Alan Kilgore and Nonna Martinov-Bennie (2015), based on the company's directors perceptions, pointed out that audit firm size, partner/manager attention to audit and communication between audit team and client management were ranked from 1st to 3rd as indicators of audit quality out of the ten audit quality attributes used in the study. Audit firm industry experience, audit quality assurance review and audit partner tenure were ranked from 8th to 10th being the least indicators.

Fiona et al. (2015) examine 266 publicly listed Australian firms and find evidence of a negative association between the length of tenure between the lead audit partner and client firm management (person-to-person relations) and audit quality. Conversely, they found a positive relation between audit firm engagement by the client (firm-to-firm) and audit quality. They pointed out that the result suggests there may be quality benefits from prescribing audit partner rotation, and quality costs from prescribing audit firm rotation.

Randal et al. (2015) find out that rotation policies are indirectly associated with higher audit quality. The mediation analysis suggests that policies that encourage Florida municipalities to consider rotation impact audit quality, rather than auditor independence, which is frequently argued to support mandatory rotation.

Christensen et al. (2016) obtained auditors' and investors' views, definitions, and indicators of audit quality and found that investors' definitions of audit quality focus more on inputs to the audit process than do auditors', and that investors view the number of the Public Company Accounting Oversight Board (PCAOB) deficiencies as an indicator of overall firm quality. They found a consensus that auditor characteristics may be the most important determinants of audit quality, and that restatements may be the most readily available signal of low audit quality.

According to Huanmin Yan and Shengwen Xie (2016), (1) there is generally no pervasive deterioration in audit quality resulting from auditors' work stress; (2) there is a significant negative association between work stress and audit quality in the initial audits of new clients; and (3) the perception of work stress depends on auditors' individual characteristics. They pointed out that auditors from international audit firms and those in the role of partner respond more

strongly to work stress than industry experts and that auditors tend to react more intensively when dealing with state-owned companies.

Ting-Chiao et al. (2016), in their study, presented that there was a significant positive relation between audit market concentration and audit fees and that concentration improves client earnings quality and reduces the need for auditors to issue modified audit opinions through increased audit fees. Additional analysis indicates that the increased audit fees and client earnings quality resulting from increased concentration are associated with a lower likelihood of executives and auditors being sanctioned by regulators for audit failures. Their study results suggest that concentration improves audit quality indirectly through increased audit fees.

Chi et al. (2016) find that both pre-client and client-specific experience improves audit quality and creditor perceptions of audit quality. They also find that audit partner pre-client experience is positively associated with audit quality early in the engagement, but not when the partner has been with the client for at least five years.

Broberg et al. (2017), through a survey sent to Swedish auditors, found out that time budget pressure lowers the quality of audits performed by Swedish auditors. Moreover, they found that audit quality is related to other factors such as gender, position, experience, number of clients, local office size and audit firm.

According to Mara et al. (2017), the diversity of audit teams in terms of the different mix of work assigned to staff, seniors, managers, and partners influences audit quality and the effect varies depending upon years of tenure. They show that the proportion of leading auditors characterized by a common educational background and the percentage of female leading auditors affect audit quality.

Zahmatkesh and Rezazadeh (2017) conducted a study in Iran and found out that professional competence, accountability and objectivity of the auditor have significant effect on the quality of an audit.

Ana Paula Lopes (2018), based on the study of the behavior of discretionary accruals in Portuguese non-listed companies, suggest that there is a relationship between audit quality and earnings manipulation.

The result of the study carried out on a sample of Iraqi nonfinancial firms by Dheyaa et al. (2018) indicates that there was a positive relationship between audit quality and the percentage of non-executive directors in the audit committee.

Joshua L. Gunn and Paul N. Michas (2018), in their study conducted using a sample of multinational client firms headquartered in the United States, consistently find that audit quality is stronger when the auditor possesses expertise conducting global group audits, possesses particular expertise in the country where a client has a significant subsidiary, or possesses both types of expertise on an engagement.

Julie et al. (2018), in their study, used a survey instrument to obtain perspectives from over 700 auditors about present-day audit workloads and the relationship between audit workloads, audit quality, and job satisfaction. Their findings indicate that high workloads result in decreased audit quality via compromised audit procedures (including taking shortcuts), impaired audit judgment (including reduced professional skepticism), and difficulty retaining staff with appropriate knowledge and skills.

Ernstberger et al. (2019) find that profit sharing in a small profit pool and high variable compensation are two characteristics of auditor compensation associated with lower audit quality. They also find some evidence suggesting that audit quality may be most at risk in cases in which partners rely more heavily on variable compensation to divide a relatively small profit pool and that these associations are more pronounced in medium-sized audit firms.

Ghafran Chaudhry and Noel O'Sullivan (2019), in their study, investigated the impact of audit committee expertise on one measure of audit quality - audit fees paid by FTSE350 companies and finds that audit committees possessing greater levels of financial expertise are associated with higher audit fees. Their findings highlight the potential value of audit committee expertise in smaller as opposed to larger listed firms, suggesting that the value of expertise to audit quality depends on the specific financial reporting challenges firms face.

Jennifer J. Gaver and Steven Utke (2019) indicate that auditors who have only recently gained the specialist designation produce a level of audit quality that does not surpass that produced by non-specialist auditors, and is generally lower than the audit quality produced by seasoned specialists. In contrast to prior research that finds no effect of specialization after propensity score matching, they find that seasoned specialists generally produce higher-quality audits than other auditors even after matching.

Hye Seung et al. (2019) found out that in terms of audit quality, higher audit fees are positively associated with female and more experienced audit partners. They claimed that their study results shed light on the important role that partner characteristics play in the demand and supply sides of audit quality.

Nurlita Haeridistia and Agustin Fadjarenie (2019), in their study conducted to analyze the effect of independence, professional ethics, and auditor's experience on audit quality in auditor at Public Accountant Firm in DKI using questionnaires given to 127 respondents, found out that independence, professional ethics and auditor's experience affect audit quality.

The results of a study conducted by Rong-Ruey et al. (2020) indicated that knowledge sharing within an audit firm is positively associated with audit quality as manifested in lower absolute discretionary accruals and the issuance of more unfavorable audit opinions. They also indicated that knowledge sharing within audit firms is associated with higher audit efficiency as represented by shorter audit lags. More importantly, the researchers claimed that both higher audit quality and audit efficiency are simultaneously associated with higher levels of knowledge sharing.

Zef Arfiansyah (2020) conducted a study on "Auditor Competence, Independence and Workload and Their Impact on Audit Quality". The results of the study showed that, for Indonesia, audit quality is more determined by the independence and professionalism of professional staffs. While independence has a positive effect, workload of professional staff has a negative effect on audit quality.

Ibrahim Albawwata and Yaser Al Frijata (2021) claimed that auditors perceive Assisted and Augmented AI systems as ease of use in auditing while perceiving Autonomous AI systems as

complicated to use. Besides, Auditors are underestimating Autonomous AI systems' capabilities and perceived it as not useful for auditing. They also stated that there was a significant difference between the perceived contributions to audit quality by the three AI systems types.

As pointed out by Salowan and Hakeem (2022), a favorable correlation existed between the audit quality of the textile sector in Iraq and the audit committee and team characteristics. The findings also showed a strong correlation between the audit committee, audit team, and audit quality of the Iraqi textile industry and an efficient audit process.

2.2.2. Studies conducted in Ethiopia

Gelaneh (2011), in his study entitled Audit Tenure and Audit quality in Ethiopia, concluded that long audit tenure increases audit quality and long audit tenure does not reduce auditor's independence based on the questionnaires completed by auditors in Addis Ababa.

Afesha (2015) studied on Audit Fees Determinants and Audit Quality in Ethiopian Commercial Banks and found out that higher audit fees, big audit firms and bank size have a positive significant effect on the external audit quality of Ethiopia.

Leilina (2015), in her study entitled Determinants of Audit Quality Evidence from manufacturing companies in Addis Ababa, Ethiopia, concluded that audit firm industry specialization, joint provision of audit and non-audit service and certified audit professionals ratio have significant effect on audit quality in Ethiopian manufacturing share companies. She found out that audit firm size and audit firm tenure has little or no significance on audit quality in manufacturing companies in Addis Ababa, Ethiopia.

Assaye (2016) pointed out that the provision of NAS to audit clients enhances audit quality, but simultaneously a separation of engagement teams, which carries out NAS from audit services, is desirable since auditors are perceived to have greater credibility when the demarcation is clear.

Kitata (2016), in his study on Factors affecting quality of External Auditing: The case of Ethiopian Commercial Banks, pointed out that the relationship between audit specialization and audit quality and audit tenure and audit quality in external audit of commercial banks in Ethiopia

was not significant whereas bank size and audit fee has a positive significant relationship with audit quality in external audit of commercial banks of Ethiopia.

Tsegaw (2017) conducted a study on Auditors Perception of Audit Quality through questionnaires completed by external auditors and found out that 1) big audit firms, audit competence, industry specialization/industry expertise knowledge by auditors and reputed audit firms are associated with higher audit quality, 2) provision of non-audit services (NAS) impairs audit quality but the problem can be mitigated if NAS is done by a separate division of an audit firm, and 3) tight audit time is negatively associated with audit quality. He stated that the respondents were neutral on the effect of long audit tenure and high audit fee on audit quality. He stated also that the respondents believed that competition on audit fee will impair audit quality in Ethiopia and receiving high audit fee will impair auditor's ability to withstand client pressure.

According to a study on 'FACTORS AFFECTING AUDIT QUALITY: THE CASE OF OFFICE OF FEDERAL AUDITOR GENERAL, ETHIOPIA' conducted by Abera (2020), motivation, independence, training, and audit time budget have a positive and significant effect on audit quality; while the other variables (competency, evidence, and quality control and assurance) seem to have no significant effect on audit quality.

Malela (2020), in his study, pointed out that audit firm rotation significantly affects audit quality in the case of commercial banks in Ethiopia.

A study conducted on the Effects of Information Asymmetry and Documentation on Audit Quality: Evidence from Public Institutions in Ethiopia by Desta (2023) indicated that audit evidence, professional competence, documentation, and auditor experience positively influence audit quality, while information asymmetry and auditor independence negatively and significantly affect audit quality.

2.3. Conclusion and Knowledge Gap

As shown in the literature review, many studies have been conducted on the effects of several factors on audit quality globally and in Ethiopia. These factors include auditor's competency, auditor's independence, audit firm size, audit fee, auditor rotation, audit time, audit tenure, and

provision of NAS. The studies have documented the effects of the factors well which confirm that they affect the audit quality at varying degrees.

The studies conducted in Ethiopia are considered few which implies that the factors affecting audit quality were not studied well and most of them are not on quality of financial statements audit in general instead they are either industry specific, example on commercial banks (Afesha, 2015; Kitata, 2016; Malela, 2020) and on manufacturing companies (Leilina, 2015) or variable specific, example on audit tenure (Gelaneh, 2011) and on provision of NAS (Assaye, 2016). Moreover, what are missing from the studies are: 1) gathering data from the regulators who are considered major stakeholders and important source of information regarding audit quality; 2) extensive review of the publications of the IAASB, the body considered the global standard setter for audit and audit related services; and 3) identification of the implications for business managers of quality of the audit of financial statements and providing recommendations as to what they should do. Hence, this study tries to fill these gaps and will contribute towards the enhancement of the quality of audits of financial statements and the awareness of the business managers regarding the implications for them of quality of the audit of financial statements.

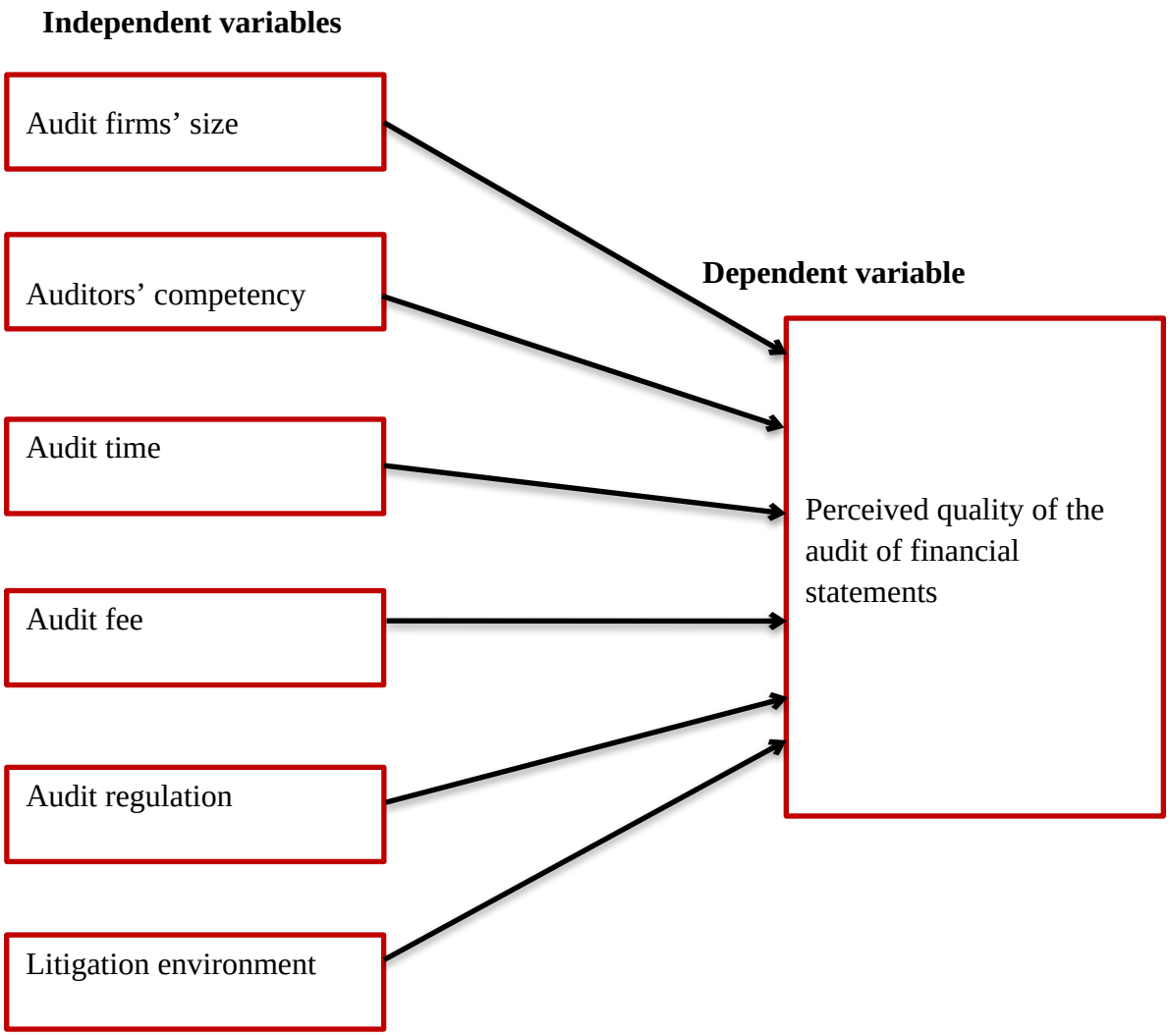
2.4. Conceptual Framework

As has been discussed in the literature review, there are several factors affecting audit quality globally and in Ethiopia. Moreover, it was noted that there are limitations in the studies conducted in Ethiopia. However, it is not practicable and even not important to study the effects of all the factors/variables. Therefore, based on the information obtained from the literature review and the researcher's own judgment, the study focused on the factors which were not touched well in the previous studies, were considered to have much more effect on audit quality in Ethiopia, and which need to be addressed in priority in order to enhance audit quality. The factors which the study addressed are: (a) Audit firms' size; (b) Auditors' competency; (c) Audit time; (d) Audit fee; (e) Audit regulation; and (f) Litigation environment.

Based on the discussion presented in the preceding paragraph and taking the knowledge gap identified in the literature into consideration, the conceptual framework is developed to represent

the relationship expected between the independent and dependent variables that are going to be studied. Figure 2.1 displays the conceptual framework for the study.

Figure 2.1: Conceptual framework of the study



2.5. Hypotheses

So far the factors affecting quality of the audit of financial statements, the knowledge gap and the conceptual framework have been discussed. Based on this information, the following empirically testable hypotheses are formulated to evaluate the conceptual framework, answer the research questions and achieve the research objectives.

H_1: Audit firms' size has positive effect on perceived quality of the audit of financial statements.

H_2: Auditors' competency has a significant positive effect on perceived quality of the audit of financial statements.

H_3: Audit time has a significant positive effect on perceived quality of the audit of financial statements.

H_4: Audit fee has a significant positive effect on perceived quality of the audit of financial statements.

H_5: Audit regulation has a significant positive effect on perceived quality of the audit of financial statements.

H_6: Litigation environment has a positive effect on perceived quality of the audit of financial statements.

CHAPTER THREE: RESEARCH DESIGN AND METHODOLOGY

The review of relevant literature presented in the preceding chapter has presented the factors affecting quality of the audit of financial statements and the need for addressing them. The review has also presented the implications of audit quality for business managers. The review further argued that it is important to identify the major factors that affect audit quality and address them in priority as it is not practicable and important to address all the factors. Thus, this study aims to examine the major factors that have impact on audit quality and the implications of audit quality for business managers. This chapter outlines the research design; the target population for the study; the sample size; the type of data to be collected, sources of data and instruments to be used; and the data analysis techniques.

3.1. Research Design

The study used explanatory (analytical) research designs. Explanatory (analytical) research is used to collect raw data and create data structures and information that allow the decision maker or researcher to model cause-and effect relationships between two or more decision variables (Mihret, 2010; Solomon, 2022). In line with this explanation, the study used the explanatory research as there was a need to establish the effect that the independent variables have on the dependent variable.

Many good researches combine both qualitative and quantitative research approach. In social science, qualitative research can accomplish research objectives that quantitative research cannot and vice versa, though it is not more so (William et al., 2013). The use of quantitative and qualitative methods in a study is considered to help counter-balance the limitations of one approach with the strengths of the other and enhance reliability of the results (Mihret, 2010). Therefore, the study used a combination of both quantitative and qualitative research approaches.

Quantitative research can be defined as a research that addresses research objectives through empirical assessments that involve numerical measurement and analysis approaches. It is used when there is a need to measure variables, assess the impact of the variables on an outcome, test theories or broad explanations and apply results to a large number of people. On the other hand, qualitative research is a research used to learn about the views of the people and is planned to

study and generate true inner meanings, new insights and theories based on participant perspectives. It is closely associated with words, ideas, feelings, and other elements that are non-quantifiable (do not have numerical measurement) and requires obtaining the right type of respondents rather than aiming to maintain representativeness (William et al., 2013; Mihret, 2010).

Surveys may be classified according to methods of communication, by the degrees of structure and disguise in the questionnaires. Questionnaires may be structured, with limited choices of (closed-ended) responses, or unstructured, to allow open-ended responses (William et al., 2013). Based on this explanation, the study at hand uses the following surveys to collect primary data from the participants: a) structured questionnaire with closed-ended questions as a quantitative component, and b) unstructured questionnaire with open-ended questions as a qualitative one.

3.2. Target Population

There were two groups of target population for the study. The first group constituted the private audit firm owners/partners. As per the data obtained from the Accounting and Auditing Board of Ethiopia (AABE), there are 216 private audit firms registered and certified by it (AABE, 2024). The second group of the target population was the combination of a) the staff of AABE holding the positions of Director General or Deputy Director General which is 1, and b) the leaders of the Ethiopian professional associations of accountants and auditors, which are 3 (Currently there are three active professional associations of accountants and auditors in Ethiopia which are: The Ethiopian Professional Accountants and Auditors Association (EPAAA); The Association of External Auditors- Ethiopia (AEA); and The Accounting Society of Ethiopia (ASE)).

3.3. Sample size Determination

The study used judgment sampling technique to select samples of the study. Judgment (purposive) sampling is a nonprobability sampling technique in which an experienced individual selects the sample based on his or her judgment about some appropriate characteristics required of the sample member. Researchers select samples that satisfy their specific purposes, even if they are not fully representative (William et al., 2013). It involves the choice of subjects who are most advantageously placed or in the best position to provide the information required. Thus, the

judgment sampling design is used when a limited number or category of people have the information that is sought. In such cases, any type of probability sampling across a cross-section of the entire population is purposeless and not useful. Based on these explanations, the researcher, based on his experience in the audit practice, used his judgment to select the samples for each category of source of data.

From the first group of target population, a sample of owners/partners of the private audit firms were selected using the judgment sampling technique to collect the data using structured questionnaire. As mentioned above, currently there are 216 private audit firms in Ethiopia. This means that there are at least 216 owners/partners whom the data can be collected from. However, it is not advisable to include all of them in the sample as they are considered to be in similar positions and have similar capacities in giving responses to the questions and the cost of collecting data from them will outweigh the benefit. Therefore, it is found appropriate to reduce the sample size. Accordingly, the researcher decided to reduce the sample size by 50% and therefore the sample size for the study is determined to be 108 with a minimum response rate of 60%. This means that 108 respondents are selected from the 216 audit firms. Only one participant is selected from each audit firm. This sample size was much higher than those used in previous related researches. For instance Bayou (2017) used 88 samples; Fekede (2015) used 20 samples and Gelaneh (2011) used 50 samples. Hence, both the sample size and the response rate were considered to be adequate for the purpose of the study.

From the second group of target population, the participants were selected with a view to generating insights from them as they are expected to provide rich information on the phenomena of interest rather than attempt to draw a representative sample. In the researcher's view, it is appropriate to use the whole population as it is considered small. Therefore, 100 % of the population of the staff of ABBE and the leaders of the accounting and auditing professional associations which were 1 and 3 respectively were selected.

3.4. Data Type, Sources and Instruments

As mentioned above, both quantitative and qualitative data were collected by the researcher through survey method of collecting data using structured and unstructured questionnaire

respectively from primary sources of data. A survey is one of the descriptive data collection methods. The survey is a cross-sectional type as the research is a type of research that collects data on relevant variables one time only from a variety of people.

Structured and unstructured questionnaires were developed mainly based on the theoretical review of literatures such as Hand Books of IAASB (IAASB, 2022; IAASB, 2020), Laws (Proclamations, Regulations and Directives) of the Government of Ethiopia relevant to the audit of financial statements (Federal Government of Ethiopia 2014; Ethiopian Council of Ministers, 2014; AABE, 2021). Moreover, some empirical studies were used (e.g., Mihret, 2010; Gelaneh, 2011; Fekede, 2015; Chemeda, 2016; Tsegaw, 2017). The researcher had also made use of his experience. They contain a set of questions related to the factors affecting perceived quality of the audit of financial statements and the implications of perceived quality of the audit for business managers which help to get answer for the research questions and to test the hypotheses with a view to achieving the research objectives. The questionnaires were prepared in English language as the respondents are considered professionals who have been using English language in carrying out most of their duties and responsibilities.

The structured questionnaire (*Instrument set A* (Appendix 1)), which was prepared for private audit firm owners/partners, contained questions which were closed-ended (or multiple choice) questions. It was developed using the likert scale so that the responses can be analyzed statistically. The Likert scale method is simple to administer and therefore extremely popular in business researchers. It is a measure of attitudes designed to allow respondents to rate how strongly they agree or disagree with carefully constructed statements, ranging from very positive to very negative attitudes toward some object (William et al., 2013). The respondents are expected to answer the questions based on their knowledge by choosing from the following choices: Strongly Agree (SA), Agree (A), Neutral (N), Disagree (DA) and Strongly Disagree (SDA). A response of Strongly Agree is assigned 5 points, Agree 4 points, Neutral 3 points, Disagree 2 points and Strongly Disagree 1 point.

The unstructured questionnaire (*Instrument set B* (Appendix 2)), which was prepared for the staff of ABBE and the leaders of the Ethiopian professional associations of accountants and auditors, contained questions which were open-ended. Open-ended questions pose some problem or topic

and allow respondents to answer the questions in any way they choose. They require that respondents have both the skill and the willingness to provide lengthy answers. Such questions can be used to learn which words and phrases people spontaneously give to the free-response question (William et al., 2013).

3.5. Distribution of Questionnaires and Follow-up

After testing the questionnaires for validity, they were distributed to the selected respondents through emails and the link for the questionnaire was sent to them so that they can access the questionnaire to answer the questions. It was expected that 45 to 60 minutes will be required to complete a questionnaire. The researcher followed up the progress of the responses and reminded the respondents through emails and/or phone calls as necessary so that the questionnaires are completed and received timely.

3.6. Test of Validity and Reliability

3.6.1. Validity

Validity is the accuracy of a measure or the extent to which a score truthfully represents a concept. In other words, are we accurately measuring what we think we are measuring? Researchers have attempted to assess validity in many ways. They attempt to provide some evidence of a measure's degree of validity by answering a variety of questions about whether the existence of a consensus among other researchers regarding attitude scale measures used by a given researcher, whether the measure cover everything that it should and whether the measure correlate with other measures of the same concept (William et al., 2013). If the validity of a research is high, it shows that the findings relate to the real properties and attributes of the physical world (Eshetu, 2022).

Before distributing the questionnaires to the respondents, they were tested for validity. As part of this, they were given to selected audit practitioners/professionals to have their comments on the questions. On top of these, before distributing the questionnaires they were examined by the advisor for their content to determine if the questions cover everything that they should with regard to the variables.

3.6.2. Reliability

The reliability of the measures was assessed using Cronbach‘s alpha. Cronbach's alpha is one of the most popular estimates of the reliability coefficient used to estimate the internal consistency of a composite score. The coefficient demonstrates whether or not the different items converge. Many researchers use α as the sole indicator of a scale’s quality. Coefficient alpha ranges in value from 0, meaning no consistency, to 1, meaning complete consistency (Mike W.L. Cheung and Paul S.F. Yip, 2005; William et al., 2013). It is a valid measure that has been widely used by prior research, including those in auditing (e.g., Mihret, 2010). The results of reliability analysis for the study are reported in Table 3.1.

Table 3.1: Reliability statistics

Variable Name	Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
Independent Variables			
Audit Firms’ Size (AFS)	.850	.863	3
Auditors’ Competency (AC)	.847	.851	3
Audit Time (AT)	.642	.650	4
Audit Fee (AF)	.696	.722	7
Audit Regulation (AR)	.762	.766	4
Dependent Variable			
Perceived Quality of the Audit of Financial Statements	.825	.864	8
Overall	.912	.927	29

Source: Compiled from SPSS output

Generally speaking, scales with a coefficient α between 0.80 and 0.95 are considered to have very good reliability. Scales with a coefficient α between 0.70 and 0.80 are considered to have good reliability, and those having α value between 0.60 and 0.70 have fair reliability. When the coefficient α is below 0.6, the scale has poor reliability (William et al., 2013). However, most researchers use 0.70 as a minimum acceptable level of coefficient alpha, whereas, in some cases 0.6 and 0.5 are also considered sufficient (Mihret, 2010). In this study, the overall Cronbach's

alpha value is 0.91. Moreover, for each variable, it is well over 0.70 in most cases and 0.60 in two cases (Table 3.1). Therefore, the survey data collected is considered to have very good reliability based on the criteria stated above.

3.7. Data Analysis Techniques

This section outlines the detailed data analysis techniques and procedures employed for both the quantitative and qualitative data.

3.7.1. Quantitative data analysis

3.7.1.1. Data screening (editing and coding)

Editing and coding are the first two stages in the data analysis process. They help the researcher in ensuring the data integrity. Data integrity refers to the concept that the data file actually contains the information that the researcher need to obtain. Fieldwork often produces data containing mistakes. Therefore, researchers need to conduct editing with a view to avoiding them. Editing is a process of checking the completeness, consistency, and legibility of data and making the data ready for coding and transfer to storage. Coding is the process of assigning a numerical score or other character symbol to previously edited data (William et al., 2013).

With these definitions and explanations in mind, before conducting the data analysis, the quantitative data were made ready for analysis by processing (editing, coding and classifying) it which involved exploring it for missing values, outliers, and distributional characteristics, if any. This was done through tabulation and using percentages. Missing values were examined to ascertain that they are random. There were no items with large number of missing values, which if any would be excluded, and the remaining missing values would not be replaced by imputed values to avoid a possible bias. This omission is expected to have little impact on the data as median values of the responses for all items under each dimension were taken for hypothesis testing. This procedure is expected to enhance the reliability of the data. There were no outlier cases identified, which if any would be excluded from the data for all hypotheses.

3.7.1.2. Descriptive analysis

Descriptive analysis is the elementary transformation of data in a way that describes the basic characteristics such as central tendency, distribution, and variability. Means, medians, modes, variance, range, and standard deviation typify widely applied descriptive statistics. The mean is simply the arithmetic average, and it is perhaps the most common measure of central tendency. Where data are measured on an ordinal scale, the median may be used as the average. The standard deviation is perhaps the most valuable index of spread, or dispersion. It has no the limitations which other measures of dispersion do (William et al., 2013). Based on these definitions and explanations, the data collected through questionnaires was converted so that it suitably represented the variables in the hypotheses. Moreover, the relevant demographic and other relevant variables were produced. This was done by a descriptive analysis using Statistical Packages for Social Sciences (SPSS). Mean and standard deviation were used to analyze the data. Median values of the item responses for each construct were also used because item responses that ranged from ‘Strongly Agree’ to ‘Strongly Disagree’ generate ordinal data. These descriptive statistics were used in similar prior studies (e.g., Mihret, 2010; Gelaneh, 2011; Wudu, 2014; Fekede, 2015; Assaye, 2016; Tsegaw, 2017).

3.7.1.3. Inferential analysis

3.7.1.3.1. Correlation

The data was analyzed through correlation analysis using SPSS with a view to indicating the relationship of one variable to another. Correlation is an interdependence technique which is concerned with how variables relate to one another. The result of correlation is denoted by the correlation coefficient, *r* which ranges from -1.0 to +1.0. If the value of *r* equals +1.0, a perfect positive relationship exists. Perhaps the two variables are one and the same! If the value of *r* equals -1.0, a perfect negative relationship exists. The implication is that one variable is a mirror image of the other. As one goes up, the other goes down in proportion and vice versa. No correlation is indicated if *r* equals 0 (William et al., 2013; Chris Brooks, 2014).

3.7.1.3.2. Multiple regression analysis

Multiple regression is a statistical technique that can be used to analyze the relationship between a dependent variable and two or more independent variables. The objective of multiple regression analysis is to use the independent variables whose values are known to predict the value of a single dependent variable (Eshetu, 2022). It is an analysis of association in which the effects of two or more independent variables on a single, interval-scaled dependent variable are investigated simultaneously (William et al., 2013). Based on these explanations, multiple regression was used for the study.

In this study, the researcher had exerted maximum effort to identify the effect of the independent variables: audit firms' size, auditors' competency, audit time, audit fee, audit regulation and litigation environment on the dependent variable: perceived quality of the audit of financial statements. The other independent variables which are not mentioned here were captured by the error term. Therefore, the general model used to test the hypotheses of the research is as follows.

$$y = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + b_5x_5 + b_6x_6 + u$$

Where:

y is the dependent variable, perceived quality of the audit of financial statements;

a is the constant;

b_1 to b_7 are the coefficients;

x_1 to x_7 are the independent variables described as follows: x_1 audit firms' size, x_2 auditors' competency, x_3 audit time, x_4 audit fee, x_5 audit regulation, x_6 litigation environment; and

u is the error term

3.7.2. Qualitative data analysis

According to William et al. (2013), qualitative research involving depth interviews, conversations, or other responses is coded by identifying the themes underlying some interview. The themes are the codes which are represented usually by words or phrases which become a key

component of a hermeneutic unit that ultimately can be linked with others to form a grounded theory. The frequency with which some thought is expressed helps to identify appropriate coding for unstructured qualitative data. Grounded theory represents an inductive investigation in which the researcher poses questions about information provided by respondents or taken from historical records; the researcher asks the questions to him or herself and repeatedly questions the responses to derive deeper explanations. Based on these concepts and explanations, the data generated from the unstructured questionnaires were analyzed using Miles and Huberman‘s three stage process of data reduction, data display and conclusion drawing as used in similar studies (e.g., Mihret, 2010). Data reduction was conducted by summarizing the responses from the questionnaires along major themes that emerged from the data. Then the reduced data was displayed in an organized fashion in matrices with rows and columns that are related to the variables in the conceptual framework of the study.

The responses were analyzed for common elements and the different categories were compared to identify patterns. This approach was also used by Mihret (2010). The data was displayed in a table for ease of identification of themes in the third stage. In this stage, inferences were drawn by closely identifying the similarities, differences, and relationships among the variables in the study. In drawing conclusions, ideal type strategy was adopted whereby indicators of the variables in the research derived from the literature were used as yardstick (Mihret, 2010).

3.7.3. Ethical consideration

According to the Social Research Association's (2003) Ethical criteria, a research shall be carried out in accordance with ethical principles and standards. To encourage ethical reflection, 14 check lists are offered. Informed permission, data protection, confidentiality, and anonymity are among the usual protocols that must be followed (Solomon, 2022). When done properly, the consent process ensures that individuals are voluntarily participating in the research with full knowledge of relevant risks and benefits (Eshetu, 2022). Therefore, while conducting this research, the researcher has used all the responses of the respondents in a manner of confidentially and full anonymity of the respondents’ identity. Moreover, the respondents were given full information about the purpose of the research and they were informed that their responses will be used for academic purposes only.

CHAPTER FOUR: DATA PRESENTATION, ANALYSIS, AND DISCUSSION OF THE RESULTS

In the previous chapter, the research design and methodology employed to test the research hypotheses to achieve the objectives of the study were discussed. In this chapter, the analyses of the data collected and the related discussions of the results are presented accordingly.

4.1. Questionnaires' Responses Rates

Based on the sample size determined in chapter 3, initially a total of 108 questionnaires were distributed to the private audit firm owners/partners (sample group 1). To compensate for the unreturned questionnaire, additional 12 questionnaires were distributed. Moreover 4 questionnaires were distributed to 1 official of ABBE and 3 leaders of the Ethiopian professional associations of accountants and auditors (Sample group 2). Finally, the researcher was able to collect a total of 82 and 2 completed questionnaires from the first and second sample groups that constituted 76% and 50% of the samples respectively. Almost all the questions contained in the questionnaires were answered properly and ready for analysis.

4.2. Descriptive Statistics and Responses for Qualitative Questions

4.2.1. Demographic information

The sample in Instrument Set A: Questionnaire for private audit firm owners/partners, which is attached as Appendix 1, comprised of 78 males (95.1 percent) and 4 females (4.9 percent. Respondents‘ age distribution ranged from 18 to 35 to over 55 years. In terms of position, the sample was composed of partners in a partnership (n=8, 9.8 percent), and principals/owners in a sole proprietorship (n=74, 90.2 percent). Descriptive statistics of the data are presented in Table 4.1.

Table 4.1: Gender, age and position of respondents

			Percent	Valid Percent	Cumulative Percent
Gender		Frequency			
Valid	Female	4	4.9	4.9	4.9
	Male	78	95.1	95.1	100.0
	Total	82	100.0	100.0	
Age					
Valid	18–35	9	11.0	11.0	11.0
	36-45	30	36.6	36.6	47.6
	46-55	37	45.1	45.1	92.7
	>55	6	7.3	7.3	100.0
	Total	82	100.0	100.0	
Position					
Valid	Partner in a partnership	8	9.8	9.8	9.8
	Principal/owner in a sole proprietorship	74	90.2	90.2	100.0
	Total	82	100.0	100.0	

Source: SPSS output, 2024

Respondents' educational levels vary from Diplomas to Master's Degrees with different professional certifications of ACCA, CPA, CIMA and CIA. The majority of the participants had more than one educational qualification. Most of them had Bachelor's Degrees with ACCA certification (n=30, 36.6 percent) followed by Bachelor's Degrees and Others with ACCA certification (n=13, 15.9 percent); Diplomas and Bachelor's Degrees with ACCA certification (n=10, 12.2 percent); and Diplomas, Bachelor's Degrees and Master's Degrees with ACCA certification (n=9, 11.0 percent). One participant, representing 1.2% of the sample had a Bachelor's Degree without any relevant professional certification. This contradicts with the actual practice of registration and certification of auditors as in Ethiopia no auditor can be registered and certified as auditor without having professional certification of either ACCA or CPA. In the researcher's view, the participant might have failed to choose the correct option

unintentionally. However, this is an isolated case which could not have impact on the data used for the study. The details of the data are presented in Table 4.2.

Table 4.2: Educational background

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	ACCA	5	6.1	6.1	6.1
	ACCA, CPA, CIMA	1	1.2	1.2	7.3
	Bachelor's Degree	1	1.2	1.2	8.5
	Bachelor's Degree, ACCA	30	36.6	36.6	45.1
	Bachelor's Degree, ACCA, Other	13	15.9	15.9	61.0
	Bachelor's Degree, Master's Degree, ACCA	2	2.4	2.4	63.4
	Bachelor's Degree, Master's Degree, ACCA, Other	1	1.2	1.2	64.6
	Diploma, Bachelor's Degree,	1	1.2	1.2	65.9
	Diploma, Bachelor's Degree, ACCA	10	12.2	12.2	78.0
	Diploma, Bachelor's Degree, ACCA, Other	1	1.2	1.2	79.3
	Diploma, Bachelor's Degree, Master's Degree, ACCA	9	11.0	11.0	90.2
	Diploma, Bachelor's Degree, Master's Degree, ACCA, CIA	1	1.2	1.2	91.5
	Diploma, Bachelor's Degree, Master's Degree, ACCA, CIMA	1	1.2	1.2	92.7
	Diploma, Bachelor's Degree, Master's Degree, ACCA, Other	1	1.2	1.2	93.9
	Master's Degree, ACCA	5	6.1	6.1	100.0
	Total	82	100.0	100.0	

Source: SPSS output, 2024

Participants‘ work experience in the external audit practice ranged from 5 to 9 years to over 34 years. Most of the participants (n=26, 31.7 percent) had 15-19 years of experience followed by 20 participants (24.4 percent), 17 participants (20.8 percent), 7 participants (8.5 percent) and 6 participants (7.3 percent) who had 25-29, 20-24, 10-14 and 30-34 years of experience respectively. Generally speaking the majority of the participants are considered well experienced which implies that they are in a good position to provide the required information for the study. The detail of the data is presented in Table 4.3.

Table 4.3: Participants’ experience in years

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	<5	0	0.0	0.0	0.0
	5-9	5	6.1	6.1	6.1
	10-14	7	8.5	8.5	14.6
	15-19	26	31.7	31.7	46.3
	20-24	17	20.8	20.8	67.1
	25-29	20	24.4	24.4	91.5
	30-34	6	7.3	7.3	98.8
	>34	1	1.2	1.2	100.00
	Total	82	100.0	100.0	

Source: SPSS output, 2024

4.2.2. Descriptive statistics of questions (items) under each variable and responses for related qualitative questions

This sub-section presents the analysis of the responses obtained from the participants for the relevant items contained in the questionnaires (*Instrument Set A* (Appendix 1) and *Instrument Set B* (Appendix 2)).

a) Audit firms' size

The descriptive statistics of the relevant items included under the independent variable, audit firms' size are presented in Table 4.4. Based on the descriptive statistics (mean, median and standard deviation) presented in the table, the levels of the contributions that the items have in describing the characteristics of audit firms' size are discussed below.

Table 4.4: Descriptive statistics of responses on audit firms' size

Item	N	Mean	Median	Std. Deviation
1. Big audit firms are more likely to handle the audits of the financial statements of big audit clients (auditees).	82	4.34	4.00	.571
2. Big audit firms are more capable to comply with all applicable law and standards such as International Standards on Auditing (ISAs) and International Standards on Quality Management (ISQMs) than smaller ones while conducting audits of financial statements.	82	4.12	4.00	.807
3. Big audit firms are more capable of achieving the objectives they set in conducting the audits of financial statements than the smaller ones.	80	4.07	4.00	.839
Valid N (list wise)	80			

Compiled from Questionnaire Set A and SPSS output, 2024

The mean is labeled as high when its value ranges from 4.01 to 5.00 or medium high when it is from 3.01 to 4.00 or medium when it is from 2.01 to 3.00 or low when it ranges from 1.00 to 2.00 and the standard deviation is described as good if its value is small or bad if its value is big as labeled and interpreted by Eshetu (2022). Mean and standard deviation were used in similar prior studies (e.g., Wudu, 2014; Assaye, 2016; Tsegaw, 2017; Abera, 2020) and other social science studies (e.g., Solomon, 2022) with similar interpretations. The median was also used in similar prior studies (e.g., Mihret, 2010; Tsegaw, 2017).

Based on these explanations, the mean of all the 3 items shown in Table 4.4 are high and the standard deviations are good. All of them have the same median of 4. These imply that the significant majority of the respondents agreed on each item. Based on the statistics, it can be concluded that all the 3 items have equivalent level of contribution, which is considered high, in describing the characteristics of audit firms' size with regard to its level of relationship with the dependent variable, perceived audit quality.

The responses for the related qualitative questions are presented in the following paragraphs. The responses were in support of the conclusions drawn above based on the descriptive statistics.

The first open-ended question was about how the respondents rate the audit firms in Ethiopia in terms of their size. The first respondent answered that most of the audit firms are sole practitioners with limited number of staff and are rated as small sizes while there are few firms which can be rated as medium. The second respondent answered by saying 'good'. In the researcher's view this answer may generally refer to the medium one.

The second open-ended question was about whether the size of an audit firm has impact on its ability of achieving the objectives it set in conducting the audit of financial statements. Both of the respondents answered 'yes'.

The third open-ended question was about what the regulators, auditors/audit firms and auditees should do to rectify the problem if most of the audit firms are considered small in size which has negative impact on the quality of the audit of financial statements. The first respondent answered that 1) the regulators shall have strong quality review system so as to deliver quality service, so that the firms will be forced to strengthen their firm by recruiting proper employees and appropriate technologies, and 2) the regulator should oblige audit firms to have minimum employees with specific qualifications to accept their clients. Firms shall be limited to serve their clients either by their type or size or number of staff in the firm in order to have normal growth with firms from time to time. The second respondent answered that the regulators should facilitate the establishment of institute of certified accountants and encourage professionalism.

The fourth open-ended question was about whether audit firms formed as partnerships are more capable of achieving the objectives they set in conducting the audits of financial statements than those formed as sole proprietorships. Both of the respondents answered 'yes'.

The fifth open-ended question was about what the regulators, auditors/audit firms and auditees should do to increase the number of partnerships. The first respondent answered as follows: 1) the regulators and associations and other related stakeholders should promote partnerships so as to make the firms to merge and work together, 2) the regulator and associations needs to identify incentives to those who want to establishes audit firms from the scratch so that they will not worry about the working capital they incur in employing proper staff and appropriate technologies. The other respondent answered that the regulators should have relevant policies.

b) Auditors' competency

The descriptive statistics of the relevant items included under the independent variable, auditors' competency are presented in Table 4.5. Based on the descriptive statistics (mean, median and standard deviation) presented in the table, the levels of the contributions that the items have in describing the characteristics of auditors' competency are discussed below.

Table 4.5: Descriptive statistics of responses on auditors' competency

Item	N	Mean	Median	Std. Deviation
1. Qualified (ACCA or CPA) auditors are considered competent.	82	4.32	4.00	.683
2. Experienced auditors are considered competent.	82	4.29	4.00	.577
3. Competent auditors are capable to achieve the objectives of the audit firm set in conducting the audits of financial statements.	82	4.39	4.00	.515
Valid N (listwise)	82			

Compiled from Questionnaire Set A and SPSS output, 2024

Based on the labels of the mean and standard deviation explained above under audit firms' size, the mean of all the 3 items shown in Table 4.5 are high and the standard deviations are good. All of them have the same median which is 4. These imply that the significant majority of the

respondents agreed on each item. Based on the statistics, it can be concluded that all the 3 items have equivalent level of contribution, which is considered high, in describing the characteristics of auditors' competency with regard to its level of relationship with the dependent variable, perceived audit quality.

c) Audit time

The descriptive statistics of the relevant items included under the independent variable, audit time are presented in Table 4.6. Based on the descriptive statistics (mean, median and standard deviation) presented in the table, the levels of the contributions that the items have in describing the characteristics of audit time are discussed below.

Table 4.6: Descriptive statistics of responses on audit time

Item	N	Mean	Median	Std. Deviation
1. Sufficient audit time must be allocated for the auditors to conduct the audit of financial statements in order to achieve the objectives of the audit firm set in conducting the audit.	82	4.51	5.00	.527
2. Auditors will be forced to skip audit procedures if the audit time allocated is inadequate.	82	4.13	4.00	.926
3. The audit firm sets audit time budget based on the nature and extent of the audit procedures to be performed irrespective of the audit fee to be charged.	82	4.13	4.00	.872
4. The audit firm sets audit time budget based on the qualification and experience of members of the engagement team irrespective of the audit fee to be charged.	82	4.16	4.00	.975
Valid N (listwise)	82			

Compiled from Questionnaire Set A and SPSS output, 2024

Based on the labels of the mean and standard deviation explained above under audit firms' size, the mean of all the 4 items shown in Table 4.6 are high and the standard deviations are good.

Three of them have the same median of 4 and one of the items has a median of 5. These imply that the significant majority of the respondents agreed on each item. Based on the statistics, it can be concluded that all the 4 items have equivalent level of contribution, which is considered high, in describing the characteristics of audit time with regard to its level of relationship with the dependent variable, perceived audit quality.

The responses for the qualitative questions are presented in the following paragraphs:

The first open-ended question was about whether sufficient audit time must be allocated for the auditors to conduct the audit in order to achieve the objectives of the audits of financial statements. The first respondent answered ‘yes’ while the other answered ‘no’.

The second open-ended question was about whether auditors will be forced to skip audit procedures if the audit time allocated is inadequate. Both of the respondents answered ‘yes’.

The third open-ended question was about whether audit firms set audit time budget based on the nature and extent of the audit procedures to be performed and taking the qualification and experience of members of the engagement team into consideration irrespective of the audit fee to be charged. The first respondent answered ‘yes’ while the other answered ‘no’.

d) Audit fee

The descriptive statistics of the relevant items included under the independent variable, audit fee are presented in Table 4.7. Based on the descriptive statistics (mean, median and standard deviation) presented in the table, the levels of the contributions that the items have in describing the characteristics of audit fee are discussed below.

Table 4.7: Descriptive statistics of responses on audit fee

Item	N	Mean	Median	Std. Deviation
1. The audit firm determines audit fees based on the time required to undertake the audit.	82	3.51	4.00	.997
2. The audit firm determines audit fees based on the number and competency of the members of the engagement team.	82	3.48	4.00	.933
3. Audit firms must not charge low audit fees with a view to getting new auditees.	79	3.77	4.00	1.120
4. Audit firm must not charge low audit fees with a view to retaining the existing auditees.	81	4.31	4.00	.683
5. Low audit fee can result in allocating less audit time.	82	4.17	4.00	.829
6. Low audit fee can result in assigning less competent audit staffs.	82	4.01	4.00	.949
7. Large audit fee may impair the independence of the audit firm.	82	4.02	4.00	.875
Valid N (listwise)	79			

Compiled from Questionnaire Set A and SPSS output, 2024

Based on the labels of the mean and standard deviation explained above under audit firms' size, the mean of the first 3 items and those of the other 4 items shown in Table 4.7 are medium high and high respectively. The standard deviations of all of the items are good. All of them have the same median of 4. These imply that the majority of the respondents agreed on the first 3 items and the significant majority of the respondents agreed on the other 4 items. Based on the statistics, it can be concluded that the first 3 items and the other 4 items have equivalent levels of contributions, which are considered medium high and high respectively, in describing the characteristics of audit fee with regard to its level of relationship with the dependent variable, perceived audit quality.

e) Audit regulation

The descriptive statistics of the relevant items included under the independent variable, audit regulation are presented in Table 4.8. Based on the descriptive statistics (mean, median and standard deviation) presented in the table, the levels of the contributions that the items have in describing the characteristics of audit regulation are discussed below.

Table 4.8: Descriptive statistics of responses on audit regulation

Item	N	Mean	Median	Std. Deviation
1. Licensing of firms and individuals to undertake audits motivates auditors to conduct effective audits of financial statements.	82	4.00	4.00	.567
2. The designation of law and standards motivates auditors to conduct effective audits of financial statements.	81	4.33	4.00	.570
3. The inspection of audits for quality motivates auditors to conduct effective audits of financial statements.	82	4.24	4.00	.658
4. Taking disciplinary action motivate auditors to conduct effective audits of financial statements.	82	4.26	4.00	.734
Valid N (listwise)	81			

Compiled from Questionnaire Set A and SPSS output, 2024

Based on the labels of the mean and standard deviation explained above under audit firms' size, the mean of the first item and those of the other 3 items shown in Table 4.8 are medium high and high respectively. The standard deviations of all of the items are good. All of them have the same median of 4. These imply that the majority of the respondents agreed on the first item and the significant majority of the respondents agreed on the other 3 items. Based on the statistics, it can be concluded that the first item has medium high level of contribution while the other 3 items have equivalent level of contribution, which is considered high, in describing the characteristics of audit regulation with regard to its level of relationship with the dependent variable, perceived audit quality.

f) Litigation environment

The descriptive statistics of the relevant item included under the independent variable, litigation environment are presented in Table 4.9. Based on the descriptive statistics (mean, median and standard deviation) presented in the table, the level of the contribution that the item has in describing the characteristics of litigation environment is discussed below.

Table 4.9: Descriptive statistics of responses on litigation environment

Item	N	Mean	Median	Std. Deviation
1. Litigation risk (a condition in which an audit firm is required to compensate a litigant for the consequences on an audit failure) will improve audit quality.	82	3.85	4.00	.891
	82			

Compiled from Questionnaire Set A and SPSS output, 2024

Based on the labels of the mean and standard deviation explained above under audit firms' size, the mean of the item shown in Table 4.9 is medium high and its standard deviation is good. It has a median of 4. These imply that the majority of the respondents agreed on the item. Based on the statistics, it can be concluded that the item has a medium high level of contribution in describing the characteristics of litigation environment with regard to its level of relationship with the dependent variable, perceived audit quality.

g) Perceived audit quality

The descriptive statistics of the relevant items included under the dependent variable, perceived audit quality are presented in Table 4.10. Based on the descriptive statistics (mean, median and standard deviation) presented in the table, the levels of the contributions that the items have in measuring perceived audit quality are discussed below.

Table 4.10: Descriptive statistics of responses on perceived audit quality

Item	N	Mean	Median	Std. Deviation
1. Audit quality is considered achieved when an engagement team applies a rigorous audit process that complied with law and applicable standards such as ISAs.	82	4.39	4.00	.491
2. Audit quality is considered achieved when an engagement team applies quality management/control procedures that complied with law and applicable standards such as ISQMs.	82	4.39	4.00	.491
3. Audit quality is considered achieved when an engagement team obtains reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.	82	4.38	4.00	.488
4. Audit quality is considered achieved when the audit firm expresses an appropriate audit opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.	82	4.40	4.00	.493
5. Audit quality is considered achieved when the audit firm reports on the financial statements, and communicate as required by the audit standards such as ISAs and other applicable law (legal and regulatory requirements), in accordance with its findings.	82	4.41	4.00	.496

6. Audit quality can be measured by the improvements in the auditees' financial reporting practices, which may result from the audit firm's findings.	82	3.67	4.00	.994
7. Audit quality can be measured by the improvements in the auditee's internal control system, which may result from the audit firm's findings.	82	3.67	4.00	.994
8. Audit quality can be measured by the timeliness of the audit reports issued.	82	3.59	4.00	.968
Valid N (listwise)	82			

Compiled from Questionnaire Set A and SPSS output, 2024

Based on the labels of the mean and standard deviation explained above under audit firms' size, the mean of the first 5 items and those of the other 3 items shown in Table 4.10 are high and medium high respectively. The standard deviations of all of the items are good. All of them have the same median of 4. These imply that the significant majority of the respondents agreed on the first 5 items and the majority of the respondents agreed on the other 3 items. Based on the statistics, it can be concluded that the first 5 items and the other 3 items have equivalent levels of contributions, which are considered high and medium high respectively, in measuring perceived audit quality.

The responses for the qualitative question are presented in the following paragraph. The responses were almost in support of the conclusions drawn above based on the descriptive statistics.

The open-ended question asked was about what the criteria used to measure audit quality are. The first respondent is in a position that the ISQM 1 & 2 and other related standards should be considered in measuring audit quality. The other respondent did not give any answer.

4.2.3. Descriptive statistics of variables

The descriptive statistics of each variable is presented in Table 4.11 which are produced after likert scale scores are determined for each of the variables using SPSS based on the likert scale scores assigned for the responses obtained from the participants for the relevant items included under the respective variables contained in the questionnaire (*Instrument Set A* (Appendix 1)).

Based on the descriptive statistics (mean and standard deviation) presented in Table 4.11, the levels of the relationship of the independent variables with the dependent variable, Perceived Audit Quality are discussed. Moreover, the level of the measure of Perceived Audit Quality is discussed.

Table 4.11: Descriptive statistics of variables

	N	Mean	Std. Deviation
Audit Firms' Size (AFS)	82	4.21	.698
Auditors' Competency (AC)	82	4.35	.575
Audit Time (AT)	82	4.34	.633
Audit Fee (AF)	82	4.20	.693
Audit Regulation (AR)	82	4.35	.596
Litigation Environment (LE)	82	3.85	.891
Perceived Quality of the Audit of Financial Statements (PQAFS)	82	4.38	.488
Valid N (listwise)	82		

Source: SPSS output, 2024

As shown in Table 4.11, the mean values of all the independent variables are above 4.00 ranging from 4.21 to 4.35 except that of Litigation Environment which is 3.85. All the variables have standard deviations of less than one which range from .575 to .891.Therefore, the mean values of the independent variables, Audit Firms' Size, Auditors' Competency, Audit Time, Audit Fee and Audit Regulation are considered high and that of Litigation Environment is considered medium high and the standard deviations of all the variables are considered good based on the labels of the mean and standard deviation explained above in section 4.2.2.2 under audit firms' size.

Moreover, the mean value of the dependent variable, Perceived Audit Quality is above 4.00, which is considered high and its standard deviation is less than one, which is considered good

Based on these descriptive statistics, it can be concluded that the significant majority of the respondents agreed that the independent variables- Audit Firms' Size, Auditors' Competency, Audit Time, Audit Fee, and Audit Regulation have positive relationship with Perceived Audit Quality. Moreover, regarding Litigation Environment, it can be considered that the majority of the respondents agreed that it has positive relationship with the dependent variable. It can be considered also that the significant majority of the respondents agreed that the measures used to measure Perceived Audit Quality were appropriate. These results are in line with all the six hypotheses presented in chapter two. However, the hypotheses will be accepted or rejected later after relevant inferential analyses are made and the hypotheses are tested accordingly.

4.2.4. Effectiveness of audit regulation

The private audit firm owners/partners were asked four separate questions in order to determine if the audit regulation in Ethiopia is effective or not. The descriptive statistics of these questions (items) is presented in Table 4.12.

Table 4.12: Descriptive statistics of effectiveness of audit regulation

Item	Mean	Median	Std. Deviation
1. In Ethiopia, the licensing of firms and individuals to undertake audits is considered effective.	3.07	3.00	.828
2. In Ethiopia, the designation of law and standards related to audits is considered effective.	3.01	3.00	.729
3. In Ethiopia, the inspection of audits for quality is considered effective.	2.67	3.00	.738
4. In Ethiopia, the responsible bodies are considered effective in taking disciplinary actions in the event of non-compliance with standards and audit failures.	3.02	3.00	.666
Overall	2.76	3.00	.620

Source: Compiled from Questionnaire Set A and SPSS output, 2024

These statistics are considered self-explanatory and thus are not described further. The conclusion is that the audit regulation (the practice of licensing of firms and individuals, designation of law and standards, inspection of audits for quality and taking disciplinary action in the event of non-compliance with standards and audit failures) in Ethiopia is considered ineffective.

The responses for the qualitative questions are presented in the following paragraphs. The responses are almost in support of the conclusion drawn above based on the descriptive statistics.

The first open-ended question asked the respondents about what roles those charged with governance of the auditees, including audit committees in Ethiopia can play towards the conduct of effective audits. The first respondent answered that the roles are 1) setting technical specifications in selecting auditors, 2) ensuring fair bidding situations, 3) following up of the audit findings and demanding value for money for the service being given by auditors. The other respondent answered that their role is to check the independence of the auditors.

The second open-ended question was about who should do what to rectify the problem if those charged with governance of the auditees, including audit committees in Ethiopia are not playing their roles in the conduct of effective audits. The first respondent answered as follows: 1) regulators need to monitor whether such committees are performing their responsibilities in appropriate manner, 2) auditors need to play this role in commenting their functions while they are conducting their audit, and 3) associations need to make public awareness programs in advocating the role of auditors, audit committees and their impact, so that the public will be critical in demanding such roles in their companies. The other respondent did not give relevant answer for the question.

The third open-ended question was about whether the audit regulation in Ethiopia is effective in motivating auditors to conduct effective audits of financial statements. The first respondent answered that so far it is effective as the monitoring and inspections was focused on capacity building and creating awareness. But, in the future, monitoring and inspection of the regulator shall be strengthened and improved so that auditors will be sanctioned for their poor quality. Such thing would have motivational factors to conduct their services in proper manner, which

ultimately improves quality of audited financial statements. The other respondent responded that there has been improvement in the inspection of audit firms but there are still more issues to be improved.

The fourth open-ended question was about the responsible bodies and the reasons behind if the audit regulation is considered ineffective. The first respondent answered that 1) the audit regulation is not ineffective with the reason mentioned in question 3 above, but in the future, the responsible bodies to regulate the industry is the, 2) the reasons for their reluctant actions are because they are focusing on capacity building rather than enforcing the laws on the firms. The other respondent answered that AABE is the responsible party.

The fifth open-ended question was about who should do what to rectify the problems with regard to the ineffectiveness of the audit regulation. The first respondent responded as follows: 1) Regulators should monitor, enforce laws and make sanctions, and 2) professional associations should work on training, capacity building and promoting of the profession in ensuring trained manpower are in the industry. The other respondent did not give relevant answer for this question.

4.2.5. Criteria used to select audit firms

The private audit firm owners/partners were asked a separate question in order to know their perception of the criteria the auditees use in selecting auditors. The descriptive statistics of this question (item) are presented in Table 4.13.

Table 4.13: Descriptive statistics of criteria used to select audit firms

Item	Mean	Median	Std. Deviation
1. Most of the auditees select audit firms mainly based on minimum audit fees quoted.	4.35	4.00	.575

Source: Compiled from Questionnaire Set A and SPSS output, 2024

These statistics are considered self-explanatory and thus are not described further. The conclusion is that most of the auditees select audit firms mainly based on minimum audit fees quoted irrespective of their capability.

The responses for the qualitative questions are presented in the following paragraphs. The responses were in support of the conclusions drawn above based on the descriptive statistics.

The first open-ended question asked the respondents if they agree with the existing general notion that the audit fees charged by most of the audit firms in Ethiopia are low because the auditees select auditors mainly based on low audit fees quoted which trigger audit firms to offer low audit fees and the auditors want to retain the existing auditees. Both of the respondents answered ‘yes’.

The second open-ended question was about what the regulators, auditors, audit clients and those charged with governance of the auditees, including audit committees should do to rectify the problem if the audit fees quoted by most of the audit firms in Ethiopia are low because the auditees select auditors mainly based on low audit fees quoted. The first respondent responded as follows: 1) regulators need to create strong awareness among the clients and the public showing the value of audit to the improvement of the company, the economy and the industry as well, 2) in addition to the awareness; regulators need to issue a directive to companies in appointing auditors to the company. Such directive could apply to public entities, 3) Audit committees shall have technical specifications to be approved by their general assembly so as to select their auditors. When such situations happen, auditors also are encouraged to compete by their technical capability rather than fee. The other respondent responded that all the concerned bodies should discuss and set minimum audit fees as the issue needs more attention.

4.2.6. Litigation environment in Ethiopia

The private audit firm owners/partners were asked a separate question to know if they have been facing litigation risk. The purpose of this question was to obtain indicative evidence as to the status of litigation environment in Ethiopia. The descriptive statistics of this question (item) are presented in Table 4.14.

Table 4.14: Descriptive statistics of litigation risk

Item	Mean	Median	Std. Deviation
1. The audit firm has been facing litigation risk.	2.02	2.00	.831

Source: Compiled from Questionnaire Set A and SPSS output, 2024

These statistics are considered self-explanatory and thus are not described further. The conclusion is that the audit firms have not been facing litigation risk (a condition in which an audit firm is required to compensate a litigant for the consequences on an audit failure).

The responses for the qualitative questions are presented in the following paragraphs. The responses are contrary to the conclusion drawn above based on the descriptive statistics. However, the in the researcher's view, the conclusion remains valid as the result of the descriptive statistics was more predominant than that of the qualitative responses.

The first open-ended question asked the respondents whether or not audit firms in Ethiopia face a litigation risk (a condition in which an audit firm is required to compensate a litigant for the consequences on an audit failure) which could help to improve audit quality. Both of the respondents agree that the firms are facing litigation risk.

The second open-ended question asked the respondents about what the reasons are behind if there is no litigation risk which audit firms face currently. Both of the respondents agree that currently there is a litigation risk faced by the firms.

The third open-ended question was about who should do what to establish a litigation environment. The first respondent responded that the associations, regulators and professionals are responsible for the establishment of litigation environment. While the other respondent claimed that the regulatory body is responsible.

4.3. Inferential Statistics

Inferential statistics project characteristics from a sample to an entire population using statistics. The primary purpose of inferential statistics is to make a judgment about a population, or the total collection of all elements about which a researcher seeks information, based from a subset of that population. Inferential statistics uses the concept of a probability distribution (William et al., 2013). Based on these explanations, the survey data was analyzed using correlation and multiple regression analyses and the hypotheses were tested accordingly as presented in the following sections.

4.3.1. Correlation analysis

Correlation is a statistical technique used to measure the strength of a relationship (association) between two variables, the result of which is denoted by the correlation coefficient, *r* which ranges from -1.0 to +1.0. If the value of *r* equals +1.0, a perfect positive relationship exists. If the value of *r* equals -1.0, a perfect negative relationship exists. No correlation is indicated if *r* equals 0 (William et al., 2013). The data was analyzed through correlation analysis with a view to determine the strength of the relationships between the independent and dependent variables. The result is presented in Table 4.15.

Table 4.15: Pearson correlation among variables

		AFS	AC	AT	AF	AR	LE	PQAFS
AFS	Pearson Correlation	1						
AC	Pearson Correlation	.707**	1					
	Sig. (2-tailed)	.000						
AT	Pearson Correlation	.536**	.547**	1				
	Sig. (2-tailed)	.000	.000					
AF	Pearson Correlation	.707**	.631**	.494**	1			
	Sig. (2-tailed)	.000	.000	.000				
AR	Pearson Correlation	.534**	.424**	.560**	.489**	1		
	Sig. (2-tailed)	.000	.000	.000	.000			
LE	Pearson Correlation	.427**	.368**	.396**	.307**	.471**	1	
	Sig. (2-tailed)	.000	.001	.000	.005	.000		
PQAFS	Pearson Correlation	.456**	.706**	.336**	.546**	.256*	.186	1
	Sig. (2-tailed)	.000	.000	.002	.000	.020	.095	

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Source: Compiled from SPSS output

Based on the Pearson Correlation results presented in Table 4.15, the following conclusions are drawn about the relationships between the dependent and independent variables.

1) The relationships among the independent variables- Audit Firms' Size (AFS), Auditors' Competency (AC), Audit Time (AT), Audit Fee (AF), and Audit Regulation (AR) and the dependent variable- Perceived Quality of the Audit of Financial Statements (PQAFS) are considered strong and positive because their correlations are significant with Pearson correlation coefficient of .456, .706, .336, .546 and .256 at significance levels of 0.000, 0.000, 0.002, 0.000 and 0.020 respectively. The implication is that the results are in line with the related hypotheses (*H1*, *H2*, *H3*, *H4* and *H5*) presented in Chapter 2. However, the decision of accepting or rejecting the hypotheses will be made later after relevant inferential analyses are made on the survey data and the hypotheses are tested accordingly.
2) The relationship between the independent variable- Litigation Environment (LE) and the dependent variable- Perceived Quality of the Audit of Financial Statements (PQAFS) is considered weak but positive because their correlation is insignificant with Pearson correlation coefficient of .186 at a significance level of 0.095. The implication is that the results are in line with the related hypothesis (*H6*) presented in Chapter 2. However, the decision of accepting or rejecting the hypothesis will be made later after relevant inferential analyses are made on the survey data and the hypothesis is tested accordingly.

4.3.2. Multiple regression analysis

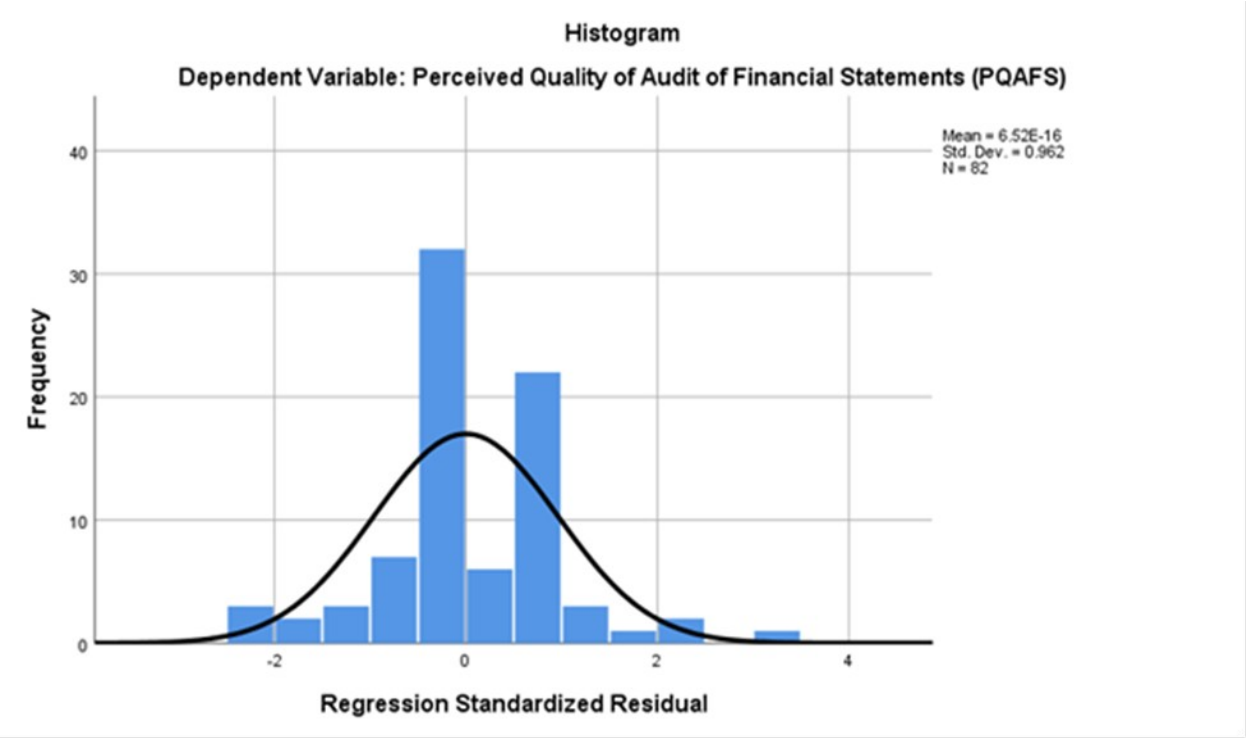
As discussed in chapter 3, multiple regression analysis was selected for the study with a view to investigating and predicting the effect of the independent variables, Audit Firms' Size (AFS), Auditors' Competency (AC), Audit Time (AT), Audit Fee (AF), Audit Regulation (AR) and Litigation Environment (LE) on the dependent variable- Perceived Quality of the Audit of Financial Statements (PQAFS). The multiple regression analysis model is presented in chapter 3. The results of the regression analysis are presented in the following sections.

4.3.2.1. Diagnostic tests on the regression model assumptions

a) Normality assumption test

One of the assumptions of regression analysis is that the sampling distribution of the mean should be normal. The normality assumption is required in order to conduct single or joint hypothesis tests about the model parameters. A normal distribution is not skewed (Chris Brooks, 2014). Normal distribution is a symmetrical, bell-shaped distribution that describes the expected probability distribution of many chance occurrences (William et al., 2013).

Figure 4.1: Normality assumption test



Source: SPSS output, 2024

The histogram (Figure 4.1) shows that the shape of the distribution is a symmetrical, bell-shaped curve indicating that most of the scores are concentrated at the middle and the rest are distributed towards the extremes (where they drift from the center) in which case their frequencies decreased. Therefore, the distribution is considered normal without violating the normality assumption.

b) Multicollinearity assumption test

An implicit assumption that is made in using regression analysis is that the explanatory variables are not correlated with one another. In any practical context, the correlation between explanatory variables will be non-zero, although this will generally be relatively benign in the sense that a small degree of association between explanatory variables will almost always occur but will not cause too much loss of precision. However, a problem occurs when the explanatory variables are very highly correlated with each other, and this problem is known as multicollinearity (Chris Brooks, 2014). Multicollinearity (sometimes just referred to as collinearity) in regression analysis refers to how strongly interrelated the independent variables in a model are. When multicollinearity is too high, the individual parameter estimates become difficult to interpret. Variance inflation factors (VIF) is used to check for the existence of multicollinearity. As a rule of thumb, VIF above 5.0 suggests problems with multicollinearity (William et al., 2013). The other way to measure multicollinearity in multiple regression is Tolerance. The Tolerance is an indication of the percent of variance in an independent that cannot be accounted for by the other independent variables, hence very small values indicate that an independent variable is redundant. Low tolerance indicates high level of multicollinearity. If tolerance gets somewhere below 0.1, then multicollinearity exists (Solomon, 2022). Based on these explanations, VIF and tolerance levels (Table 4.16) are used for the study.

Table 4.16: Multicollinearity assumption test

Model	Collinearity Statistics	
	Tolerance	VIF
(Constant)		
Audit Firms' Size (AFS)	.351	2.849
Auditors' Competency (AC)	.434	2.306
Audit Time (AT)	.554	1.803
Audit Fee (AF)	.447	2.237
Audit Regulation (AR)	.554	1.805
Litigation Environment (LE)	.719	1.392

Source: SPSS output, 2024

As shown in Table 4.16, the VIF and Tolerances for all of the independent variables are well below 5 and above 0.1 respectively which are within those taken as standards and used in prior studies. Therefore, multicollinearity is not a threat for the regression analysis.

c) Autocorrelation assumption test

Autocorrelation assumption is that the covariance between the error terms over time (or cross-sectionally, for that type of data) is zero. In other words, it is assumed that the errors are uncorrelated with one another. If the errors are not uncorrelated with one another, it would be stated that they are 'autocorrelated' or that they are 'serially correlated'. A test of this assumption is therefore required (Chris Brooks, 2014). The Durbin-Watson statistic is commonly used to test for autocorrelation. It can be applied to a data set by statistical software. The outcome of the Durbin-Watson test ranges from 0 to 4. An outcome closely around 2 means a very low level of autocorrelation. An outcome closer to 0 suggests a stronger positive autocorrelation, and an outcome closer to 4 suggests a stronger negative autocorrelation (Eshetu, 2022). The residuals are not correlated if the Durbin-Watson statistic is approximately 2, and an acceptable range is 1.50 - 2.50 (Solomon, 2022). For the study at hand, the Durbin-Watson statistic is presented in Table 4.17.

Table 4.17: Autocorrelation assumption test using Durbin Watson statistics

Model	Durbin-Watson
1	1.562

Source: SPSS output, 2024

As can be seen from the table above, the Durbin-Watson statistic value is 1.562 which is within the acceptable range of 1.50 - 2.50. Therefore, it can be considered that there is no autocorrelation problem in the model used for the study.

4.3.2.2. Multiple regression analysis result and discussion

In the previous section diagnostic tests were conducted on the five Classical Linear Regression Model (CLRM) assumptions and the researcher ensured that the entire model fulfills all the

assumptions. In the next sections, the results of the multiple regression analysis conducted on the survey data are presented.

a) Model summary

The model summary for the study is presented in Table 4.18.

Table 4.18: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.737[a]	.543	.506	.343

a. Predictors: (Constant), Auditors' Competency, Litigation Environment, Audit Regulation, Audit Time, Audit Fee, Audit Firms' Size

b. Dependent Variable: Perceived Quality of Audit of Financial Statements

Source: SPSS output, 2024

The coefficient of determination, R Square *(R^2)*, measures that part of the total variance of the dependent variable that is accounted for by knowing the value of the independent variables. What is an "acceptable" R^2 value? Guidelines for R^2 values are neither simple nor straightforward. Indeed, good and bad values for the coefficient of determination depend on so many factors that a single precise guideline is considered inappropriate. The focus should be on the *F*-test of significance (William et al., 2013). This will be explained in the next section. As can be seen from Table 4.18, R^2 was .543 for the study at hand. Therefore, about 54.3 % of the variance in the Perceived Quality of the Audit of Financial Statements can be explained by the variance in Auditors' Competency, Litigation Environment, Audit Regulation, Audit Time, Audit Fee and Audit Firms' Size. This means that the remaining 45.7 percent of the variation was explained by other factors which are not included in this study.

b) Analysis of variance (ANOVA)

An implicit question with the use of ANOVA is, "How can the dependent variable best be predicted?" Multiple regression models often are used to test some proposed theoretical model. In doing so the first step is to examine the model *F*-test. Then the overall significance of the model should be interpreted. The output will include the "model *F*" and a significance value. When the

model *F* is significant (low p-value), the independent variable explains a significant portion of the variation in the dependent variable. If the test result is not significant, the model should be dismissed and there is no need to proceed to further steps (William et al., 2013). The ANOVA result for the study is presented in Table 4.19.

Table 4.19: ANOVA table

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.469	6	1.745	14.852	.000[b]
	Residual	8.811	75	.117		
	Total	19.280	81			
a. Dependent Variable: Perceived Quality of the Audit of Financial Statements b. Predictors: (Constant), Auditors' Competency, Litigation Environment, Audit Regulation, Audit Time, Audit Fee, Audit Firms' Size						

Source: SPSS output, 2024

As per the ANOVA statistics presented in Table 4.19, the *F* of the model for the study was 14.852, which was considered highly significant with $p<0.001$, implying that the model results appear strong and the researcher can proceed to further steps. Based on this result, it can be concluded that the independent variables explain a large portion of the variance in the dependent variable. The model R^2, as indicated in the model summary in the previous section, was 0.543 also supporting this conclusion.

c) Regression coefficients

Multiple regression involves multiple slope estimates, or regression weights. One challenge in regression models is to understand how one independent variable affects the dependent variable, considering the effect of other independent variables. When the independent variables are related to each other, the regression weight associated with one independent variable is affected by the regression weight of another. Regression coefficients are unaffected by each other only when

independent variables are totally independent (William et al., 2013). The results for the independent variable tests are presented in Table 4.20.

Table 4.20: Regression coefficients

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	1.835	.345		5.321	.000
	Audit Firms' Size (AFS)	-.129	.092	-.184	-1.396	.167
	Auditors' Competency (AC)	.616	.101	.725	6.119	.000
	Audit Time (AT)	-.048	.081	-.062	-.596	.553
	Audit Fee (AF)	.197	.082	.280	2.395	.019
	Audit Regulation (AR)	-.026	.086	-.031	-.298	.766
	Litigation Environment (LE)	-.027	.050	-.049	-.531	.597

a. Dependent Variable: Perceived Quality of the Audit of Financial Statements (PQAFS)

Source: SPSS output, 2024

Before testing the hypotheses, the regression model ($\boldsymbol{y = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + b_5x_5 + b_6x_6 + b_7x_7 + u}$) developed in chapter 3 is expressed by using the relevant statistics presented in Table 4.20. The statistics include the standardized or unstandardized regression coefficients.

According to William et al. (2013), standardized regression coefficient (*ß*) is the estimated coefficient indicating the strength of relationship between an independent variable and dependent variable expressed on a standardized scale (range is from -1 to 1). It is used when researchers want to know which independent variable is most predictive of the dependent variable. One huge advantage of *ß* is that it provides a constant scale. In other words, the ßs are directly comparable. If the purpose of the regression analysis is forecasting, then raw parameter estimates (unstandardized coefficients) must be used. This is another way of saying that the researcher is interested primarily in prediction. Based on these explanations, the unstandardized coefficients were used for the study at hand. Therefore, the unknown Beta values of the regression model are now replaced by the unstandardized coefficients. The unstandardized coefficients represent the amount by which the dependent variable will change if the independent variable change by one unit and they depict the direction of the relationship among the independent and dependent

variables. The amount for the constant (***a)*** and the independent variables are inserted accordingly. Now the regression model is expressed as follows:

PQAFS = 1.835 + -.129 (AFS) +.616 (AC) + -.048 (AT) + .197(AF) + -.026(AR) + -.027(LE) + *u*

Based on the model, four of the independent variables (Audit Firms' Size, Audit Time, Audit Regulation and Litigation Environment) have negative Unstandardized Coefficients of Beta while two of them (Auditors' Competency and Audit Fee) have positive ones reflecting negative and positive effects respectively on the dependent variable, PQAFS. To decide as to whether the effects of the independent variables on the dependent variable are negative or positive, the significance levels must be considered. The detail of this and the decision on the hypotheses are presented in the subsequent section.

4.3.2.3. Hypotheses testing

In this section, the hypotheses of the research are tested based on the results of the independent variables presented in the previous section (Section 4.2.3.2.2.c). The hypotheses are accepted or rejected based on the Unstandardized Coefficients of Beta of the independent variables and the respective significance levels. Summary of the results of the independent variables and the decision regarding the hypotheses is presented in Table 4.21.

Table 4.21: Summary of the results of the independent variables and hypotheses testing

Independent Variables	Result		Hypotheses	Decision
	Beta (*B*)	P		
Audit Firms' Size (AFS)	-.129	.167, i.e., >0.05	H_1	Reject
Auditors' Competency (AC)	.616	.000, i.e., <0.05	H_2	Accept
Audit Time (AT)	-.048	.553, i.e., >0.05	H_3	Reject
Audit Fee (AF)	.197	.019, i.e., <0.05	H_4	Accept
Audit Regulation (AR)	-.026	.766, i.e., >0.05	H_5	Reject
Litigation Environment (LE)	-.027	.597, i.e., >0.05	H_6	Reject

Source: Compiled from SPSS output

Hypothesis 1

H_1: *Audit firms' size has positive effect on perceived quality of the audit of financial statements.*

As can be seen from Table 4.21, audit firms' size is negatively related to perceived quality of the audit of financial statements with *B* = -.129 and p-value of 0.167 which is > 0.05, the significance level set for the study. This shows that there will be a 0.129 decrease in the perceived audit quality for a unit increase in audit firms' size. The result did not support the hypothesis because it was not in the expected direction (the expected direction was positive) though it was statistically insignificant (p > 0.05). The result implied that audit firm size was not considered a proper explanatory variable of perceived audit quality in Ethiopia. Therefore, **Hypothesis 1**, *Audit firms' size has positive effect on perceived quality of the audit of financial statements*, is rejected.

The result of the study was not in conformity with the findings reported in similar prior studies (e.g., DeAngelo, 1981; Enofe et al., 2013; Sawan and Alsaqqa, 2013; Alan et al., 2014; Alan Kilgore and Nonna Martinov-Bennie, 2015; Tsegaw, 2017). These studies reported that audit firm size has a positive relationship with audit quality. However, the result of the study was supported by the findings of Leilina (2015), which claimed that audit firm size did have negative and insignificant effect on audit quality in Ethiopian manufacturing companies.

Hypothesis 2

H_2: *Auditors' competency has a significant positive effect on perceived quality of the audit of financial statements.*

Auditors' competency is positively related to perceived quality of the audit of financial statements with *B* = 0.616 and p-value of 0.000 which is <0.05, the significance level set for the study. This shows that there will be a 0.616 increase in the perceived audit quality for a unit increase in auditors' competency. The results support the hypothesis because the *B* = 0.616 is both in the expected direction (positive) and significant (p <0.05). Therefore, **Hypothesis 2**, *Auditors' competency has a significant positive effect on perceived quality of the audit of financial statements*, is accepted.

Previous studies (e.g., Leilina, 2015; Chi et al., 2016; Mara et al., 2017; Tsegaw, 2017; Zahmatkesh and Rezazadeh, 2017; Joshua L. Gunn and Paul N. Michas, 2018; Desta, 2023) have also reported similar findings. The theoretical literature suggests also that auditors' competency is one of the major factors that affect audit quality. According to IAASB, one of the key audit quality attributes under the input factors of values, ethics and attitudes at the engagement level is professional competence and due care whereby all members of the engagement team are required a) to develop and maintain professional knowledge and skill at an appropriate level; b) to act carefully, thoroughly and on a timely basis; and c) to act diligently in accordance with applicable technical and professional standards (IAASB, 2022).

Hypothesis 3

***H_3**: Audit time has a significant positive effect on perceived quality of the audit of financial statements.*

Audit time is negatively related to perceived quality of the audit of financial statements with B = -.048 and p-value of 0.531 which is > 0.05, the significance level set for the study. This shows that there will be a 0.048 decrease in the perceived audit quality for a unit increase in audit time. The result did not support the hypothesis because it was not in the expected direction (the expected direction was positive) though it was statistically insignificant ($p > 0.05$). The result implied that audit time was not considered a proper explanatory variable of perceived audit quality in Ethiopia. Therefore, **Hypothesis 3**, *Audit time has a significant positive effect on perceived quality of the audit of financial statements*, is rejected.

The result of the study was not in conformity with the findings reported in similar prior studies (e.g., Broberg et al., 2017; Tsegaw, 2017; Julie et al., 2018 and Abera, 2020) which have reported that audit time is positively related to audit quality. According to IAASB, audit time is one of the input factors that affect audit quality at both the engagement and firm levels. For instance, at the engagement level, partners and staff should have sufficient time to undertake the audit in an effective manner (IAASB, 2022).

Hypothesis 4

***H_4**: Audit fee has a significant positive effect on perceived quality of the audit of financial statements.*

Audit fee is positively related to perceived quality of the audit of financial statements with B = .197 and p-value of 0.019 which is <0.05, the significance level set for the study. This shows that there will be a 0.197 increase in the perceived quality of the audit of financial statements for a unit increase in audit fee. The results support the hypothesis because the B = 0.197 is both in the expected direction (positive) and significant (p <0.05). Therefore, **Hypothesis 4**, *Audit fee has a significant positive effect on perceived quality of the audit of financial statements,* is accepted.

Similar findings were reported by previous studies (e.g., Al-Khaddash et al., 2013; Afesha, 2015; Kitata, 2016; Ting-Chiao et al., 2016; Tsegaw, 2017). The World Bank reported that most auditors in Ethiopia complained that audit fees are very low and may not cover costs of a good standard audit (World Bank, 2007). Evidence from theoretical literature also supports the findings of the study. For instance, according to IAASB, the quality of the audit can be influenced through the allocation of sufficient audit resources for the audit to be effectively performed which should be fairly reflected by the audit fee (IAASB, 2022).

Hypothesis 5

***H_5**: Audit regulation has a significant positive effect on perceived quality of the audit of financial statements.*

Audit regulation is negatively related to perceived quality of the audit of financial statements with B = -.026 and p-value of 0.766 which is > 0.05, the significance level set for the study. This shows that there will be a 0.026 decrease in the perceived audit quality for a unit increase in audit regulation. The result did not support the hypothesis because it was not in the expected direction (the expected direction was positive) though it was statistically insignificant (p > 0.05). The result implied that audit regulation was not considered a proper explanatory variable of perceived audit quality in Ethiopia. Therefore, **Hypothesis 5**, *Audit regulation has a significant positive effect on perceived quality of the audit of financial statements*, is rejected.

The result of the study was not in conformity with the findings reported in similar prior studies (e.g., Fekede, 2015; Nurlita Haeridistia and Agustin Fadjarenie, 2019) which reported that audit regulation has positive relationship with audit quality. The World Bank report emphasized the need for licensing of auditors, bringing requirements for accounting and auditing up to date with good international practices, enhancing the oversight of audit and assurance services, and enacting a dedicated law and establishing dedicated institutions for regulation of the accountancy profession with a view to contributing towards audit quality (World Bank, 2007). According to IAASB, the functions related to audit regulation are commonly undertaken at a national level by independent regulators, professional accountancy organizations, or a combination of the two with a view to enhancing audit quality (IAASB, 2022).

Hypothesis 6

H_6**: Litigation environment has a positive effect on perceived quality of the audit of financial statements.**

Litigation environment is negatively related to perceived quality of the audit of financial statements with B = -.027 and p-value of 0.597 which is > 0.05, the significance level set for the study. This shows that there will be a 0.027 decrease in the perceived audit quality for a unit increase in litigation environment. The result did not support the hypothesis because it was not in the expected direction (the expected direction was positive) though it was statistically insignificant (p > 0.05). The result implied that litigation environment was not considered a proper explanatory variable of perceived audit quality in Ethiopia. Therefore, **Hypothesis 6**, *Litigation environment has a positive effect on perceived quality of the audit of financial statements*, is rejected.

There is a possibility that the audit firm will be required to compensate a litigant for the consequences on an audit failure. Some believe that it will improve audit quality as it will cause the auditor to minimize the chance of an audit failure. Others believe that it will have an adverse impact on audit quality as it will result in a “checklist” mindset rather than a willingness to think about ways of addressing audit risk in an innovative manner, and act as a disincentive to talented individuals to join, or remain in the auditing profession (IAASB, 2022).

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

This final chapter aims to conclude the study. It outlines the major results and findings. Conclusions are drawn and recommendations are made based on the key results and findings. Finally, directions for future research are provided.

5.1. Summary of Results and Findings

The demographic information part of the descriptive statistics revealed that the majority of the respondents are male (95.1 percent). In terms of their age, the majority are in the age range of 46 to 55 (45.1 percent) followed by the age range of 35 to 45 (36.6 percent). With regard to position, the principals/owners in sole proprietorships constituted the highest number with 90.2 percent. Most of them had Bachelor‘s Degrees with ACCA certification which is 36.6 percent followed by Bachelor’s Degrees and Others with ACCA certification amounting to 15.9 percent. 11 percent of the participants had Diplomas, Bachelor‘s Degrees and Master’s Degrees with ACCA certification. Most of the participants (31.7 percent) had 15-19 years of experience followed by 20 participants (24.4 percent) and 17 participants (20.8 percent) who had 25-29 and 20-24 years of experience respectively.

The descriptive statistics of the variables revealed that the mean values of the independent variables, Audit Firms’ Size, Auditors’ Competency, Audit Time, Audit Fee and Audit Regulation are above 4.00 ranging from 4.21 to 4.35 and that of Litigation Environment is 3.85. All the variables have standard deviations of less than one which range from .575 to .891. This implies that the significant majority of the respondents agreed that Audit Firms’ Size, Auditors’ Competency, Audit Time, Audit Fee, and Audit Regulation have positive relationship with the dependent variable, Perceived Audit Quality, while the majority of the respondents agreed that Litigation Environment has positive relationship with the dependent variable.

Other descriptive statistics related to some special purpose questions (items) revealed that 1) The audit regulation in Ethiopia is considered ineffective; 2) Most of the auditees select audit firms

mainly based on minimum audit fees quoted irrespective of their capability; and 3) the audit firms have not been facing litigation risk.

The Pearson correlation analysis revealed that there are statistically significant relationships among the independent variables- Audit Firms' Size, Auditors' Competency, Audit Time, Audit Fee, and Audit Regulation and the dependent variable- Perceived Audit Quality with Pearson correlation coefficient of .456, .706, .336, .546, .256 and .354 respectively. Moreover, it revealed that the relationship between Litigation Environment and the dependent variable was statistically insignificant with Pearson correlation coefficient of .186. However, the relationship is positive.

The model summary in the multiple regression analysis revealed R square of 0.543 implying that about 54.3 % of the variance in the dependent variable- Perceived Audit Quality can be explained by the variance in independent variables- Auditors' Competency, Litigation Environment, Audit Regulation, Audit Time, Audit Fee and Audit Firms' Size. This means that the remaining 45.7 percent of the variation was explained by other factors which are not included in this study. Moreover, the *F* of the model was 14.852 with p value of 0.000 (<0.001), which was considered highly significant, implying that the model was acceptable.

Based on the model, four of the independent variables- Audit Firms' Size, Audit Time, Audit Regulation and Litigation Environment have negative Unstandardized Coefficients of Beta with p values of >0.05, the significance level set for the study reflecting negative effects on the dependent variable- Perceived Audit Quality. Because the coefficients were negative, they were not in the predicted/expected positive directions. Therefore, though the results were considered statistically insignificant since the p values were >0.05, the related hypotheses were rejected. Two of the independent variables- Audit Fee and Auditors' Competency have positive Unstandardized Coefficients of Beta with p values of <0.05 reflecting positive effects on the dependent variable. As the coefficients are in the expected direction and significant (p<0.05), the results support the related hypotheses. Therefore, they are accepted.

5.2. Conclusion

Audit of financial statements adds credibility to the financial statements which in turn enhances the degree of confidence of intended users in the financial statements. This means that the users

of financial statements rely on the information obtained from the audited financial statements in making financial, operational and other decisions which have economic impact. To this effect, audit quality is of paramount importance to the intended users. Therefore, the issue of audit quality is a major concern for them.

Audit quality is a complex issue because 1) its achievement requires the involvement of various stakeholders such as auditors; auditees; creditors/lenders and customers of auditees; governmental bodies including regulators; potential investors; and researchers, and 2) it is affected by various factors. Therefore, it is mandatory that the stakeholders play their role towards the achievement of audit quality. Moreover, it is important to identify the factors that affect audit quality with a view to taking actions in order to minimize the negative impacts of the factors.

Several studies on the factors affecting audit quality have been conducted. The findings of these studies have provided varying evidence related to the impact of the factors on audit quality. As discussed in Chapter two, the studies conducted in Ethiopia are found to be limited, most of which are either industry specific or variable specific.

In light of the above evidence, the study at hand was initiated. The general objective of the study was to explore the major factors that affect perceived quality of the audit of financial statements in Ethiopia and provide recommendations to the stakeholders which help to reduce the negative impact of the factors to an acceptable low level with a view to enhancing the quality of the audit. Based on this objective, several specific objectives, research questions and testable hypotheses were developed.

The study explored some input and contextual (environmental) factors which were categorized as independent variables. These variables were considered major in terms of their impact on audit quality (the dependent variable) in Ethiopia and therefore need to be addressed in priority. It also examined the level of the impacts of the independent variables on the dependent variable and categorized them accordingly.

To achieve the intended objective the study used both quantitative and qualitative approaches. The quantitative data were collected from a sample of 82 private audit firm owners/partners

through questionnaires containing closed-ended question. The qualitative data were collected from a top level management staff of AABE and one leader from the Ethiopian associations of professional accountant and auditors. The collected data were analyzed through descriptive and inferential statistics using SPSS and excel. The results and findings of the study are presented in detail in Chapter 4 and summarized above under section 5.1.

Based on these results and findings, the following conclusions have been reached.

1) Though the results were not in the predicted/expected directions (the expected directions were positive), audit firms' size, audit time, audit regulation and litigation environment had negative but statistically insignificant effect on perceived audit quality.
2) Auditors' competency had a significant positive effect on audit quality.
3) Audit fee has a significant positive effect on audit quality. According to IAASB, there is usually a relationship between the quality of an audit and the quality and quantity of the resources used in its performance; this will usually be reflected in the audit fee. However, a low audit fee can never be a justification for failure to adequately resource an audit and obtain sufficient appropriate audit evidence. It is important that audit committees consider whether sufficient audit time is planned. This is especially important when audit fees are negotiated directly with management. Management is often highly influential in determining audit fees, and may have a different perspective on audit quality from that of the audit committee (IAASB, 2022).
4) The audit regulation in Ethiopia was considered ineffective.
5) Most of the auditees have been selecting audit firms mainly based on minimum audit fees quoted irrespective of their capability. The World Bank reported that most auditors in Ethiopia complained that the audit fees in the country are very low and this is indicative of little appreciation of high quality audit services (World Bank, 2007).
6) The audit firms has not been facing litigation risk (a condition in which an audit firm is required to compensate a litigant for the consequences on an audit failure). According to Alan Kilgore and Nonna Martinov-Bennie (2015), audit quality has since the turn of the millennium become a major concern for regulators and standard setters, partly as a result

of the series of globally reported corporate collapses that marked the early years of the new millennium, many of which were associated with audit failure.

7) Audit firms' size; auditors' competency; audit fee and audit time have implications for business managers as they are expected to use them as criteria in selecting auditors for their business entities. Quality of the audit of financial statements has several implications for business managers. The implications include improvement in their entities' a) internal control and accounting systems which include the financial reporting system; b) financial and non-financial performances; c) fulfillment of their legal and other regulatory requirements; and d) management functions of planning, organizing coordinating, and controlling.

5.3. Recommendations

Based on the conclusion presented above, the following recommendations are provided to the regulator (AABE), audit firms (auditors), professional associations of accountants and auditors, higher education institutions, auditees and those charged with governance, such as audit committees.

- Auditors' competency has a significant positive effect on audit quality. Therefore,
  1) AABE is advised to
     a) Maximize its efforts of organizing relevant extensive trainings and workshops including training-of-trainers in collaboration with other concerned stakeholders or creating conducive environment for such programs.
     b) Reinforce the rules, policies and procedures which require auditors and accountants to undertake continuous professional development programs.
  2) Audit firms should ensure that members of the audit engagement team assigned for each audit engagement have the competency required for the audits. If they do not have competent staffs or are not in a position to get such staffs outside the firm, they should not accept or withdraw from the engagement. Moreover, they should encourage their staffs to update them through continuous professional development programs by way of trainings, workshops and other relevant means. In line with this, they should cover the relevant costs which the staffs incur in updating themselves.

3) Professional associations of accountants and auditors are recommended to reinforce their rules, policies and procedures which require auditors and accountants to undertake continuous professional development programs. Moreover, they should maximize the efforts of organizing relevant trainings and workshops including training-of-trainers in collaboration with other concerned stakeholders.

- Because audit fee has a significant positive effect on audit quality, audit firms are advised to ensure that the audit fees they quote are commensurate with the time required and the qualification and experience of the members of the engagement teams assigned to conduct the audits. To do this, they need to obtain information about the nature and size of businesses of the entitities to be audited and the volume of their transactions.
- Because most of the auditees select audit firms mainly based on minimum audit fees quoted irrespective of their capability,
  1) ABBE is recommended to establish a mechanism by which it ensures that the auditees use appropriate criteria, which give emphasis to technical specifications, in selecting and appointing audit firms and that the audit firms set their audit fees using appropriate criteria, which give emphasis to the use of sufficient and appropriate financial and non-financial data obtained from the auditees for the period subject to the audit.
  2) The auditees should establish appropriate criteria, which incorporate relevant technical specifications, and use them in selecting and appointing audit firms.
  3) The audit firms are advised to establish relevant criteria, which emphasize the use of sufficient and appropriate financial and non-financial data obtained from the auditees for the period subject to the audit, and use them in setting audit fees.
- Business managers should incorporate audit firms' size; auditors' competency; audit fee and audit time as part of their criteria used to select auditors so that they can benefit from the outcome. Moreover, they should play their role towards the achievement of audit quality. Their roles may include: creating conducive environments for the audits and providing all the relevant information and evidences as and when requested by the auditors. They are also advised to implement the recommendations given by the auditors as appropriate.

5.4. Directions for Future Research

The researcher believes that further researches related to audit quality should be conducted in Ethiopia because prior researches, including the study at hand, are found to be limited. These researches had examined only some of the factors affecting audit quality in limited settings. Therefore, future researches should be conducted on factors which were not addressed at all and not addressed well. The researcher encourages further research to extend the results of this study, improve the results by minimizing its limitations, and/or confirm the results in different settings. Replicating this study in other settings helps to validate the conclusions. Studies using other population targets, for instance business CEOs or CFOs or authorized accountants could provide useful insights. Especially, emanating from one of the limitations of the study (judgment sampling), a replication of this study in different settings based on random samples could help to get additional evidence.

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APPENDICES

Appendix 1: Instrument Set A: Questionnaire for private audit firm owners/partners

Belete Tensaye Wakeyo,

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1 March 2024

Dear Sir/Madam:

The enclosed questionnaire is designed to gather information about quality of the audit of financial statements in Ethiopia. The questionnaire has been sent to owners/partners in 113 private audit firms in Addis Ababa, Ethiopia. The information you provide in response to the items in the questionnaire will be used as part of the data needed for a study on *Factors Affecting Perceived Quality of Financial Statements Audit in Ethiopia: Implications for Managers of Ethiopian Businesses*. The study is being conducted by the undersigned researcher in partial fulfillment of the requirements for the Master of Business Administration at Addis Ababa University, Ethiopia. The results of the study are expected to contribute to the audit profession (audit theory and practice) in the understanding of factors affecting perceived quality of the audit of financial statements in Ethiopia and the implications of the perceived quality of the audit for business managers.

The questionnaire is anonymous; please do not write your name on it. The conclusions of the study will be drawn in aggregate terms, without any reference to specific individual respondents.

I would also like to assure you that the information you provide will be accessible only to the undersigned researcher only.

Further, I would like to advise that participation in this survey is completely voluntary. Nevertheless, your participation is regarded as a valuable assistance. I believe that you will extend your assistance by participating in the study.

If you have any questions about this survey, please do not hesitate to contact me using my phone number 0911478963 or via my email address: wtensayebelete@gmail.com.

Thank you for your participation.

Kind regards,

Belete Tensaye

General Instruction: This questionnaire contains 5 pages and is expected to take about 45 minutes of your time to complete. Please provide your responses to the questions based on the instructions under each section.

Section I: General questions

Gender (Please indicate your choice by putting the mark X in the space below your response option)

Male	Female

2. Age (Please indicate your choice by putting the mark X in the space below your response option)

18 – 35	36- 45	46- 55	>55

Your qualification (Please indicate your choice by putting the mark X in the space below your response option. You can choose more than one option if applicable)

Diploma	Bachelor's Degree	Master's Degree	PhD	ACCA	CPA	CIMA	CIA	Other

4. Your current position/status in the firm

Principal/owner in a sole proprietorship	Partner in a partnership

5. If your answer to the above question is 'partner in a partnership', how many partners are there in the partnership including yourself? _____

6. Work experience in external audit in years: _____

7. Number of audit staffs in your firm including the owner/principal/partners (Please indicate your choice by putting the mark X in the space below your response option)

Less than 5	5 to 10	11 to 15	16 to 20	21 to 25	More than 25

8. How many qualified (ACCA and/or CPA) audit staffs are there in your firm including the owner/principal/partner(s)? _____

9. How many audit managers and assistant audit managers are there in your firm excluding the owner/principal/partners? _____

Section II – Factors affecting quality of the audit of financial statements in Ethiopia

Instruction 1: Below are statements pertaining to a) some of the factors affecting perceived quality of the audit of financial statements (audit quality) in Ethiopia at each audit engagement and/or firm and/or national (country) levels, and b) perceived audit quality. Most of the factors are related to the audit firms and other stakeholders in general and some which are specific to your audit firm. Taking this explanation into consideration, please indicate your choice by ticking (X) in the appropriate box from the options given as Strongly Agree, Agree, Neutral, Disagree and Strongly Disagree.

A. Audit firms' size	**Strongly Agree**				**Strongly Disagree**
1. Audit firms having many clients are considered big firms.					
2. Audit firms having many qualified (ACCA and/or CPA) audit staffs are considered big firms.					
3. Audit firms having many experienced audit staffs are considered big firms.					
4. Audit firms formed as partnerships are more likely to become big firms than those formed as sole proprietorships.					
5. Big audit firms are more likely to handle the audits of the financial statements of big audit clients (auditees).					
6. Big audit firms are more capable to comply with all applicable law and standards such as International Standards on Auditing (ISAs) and International Standards on Quality Management (ISQMs) than smaller ones while conducting audits of financial statements.					

7. Big audit firms are more capable of achieving the objectives they set in conducting the audits of financial statements than the smaller ones.					
B. Auditors' competency (Knowledge, skill, attitude and potential for future development)					
1. Qualified (ACCA or CPA) auditors are considered competent.					
2. Experienced auditors are considered competent.					
3. Competent auditors are capable to achieve the objectives of the audit firm set in conducting the audits of financial statements.					
C. Audit time (Time allocated for auditors to perform the audit)					
1. Sufficient audit time must be allocated for the auditors to conduct the audit of financial statements in order to achieve the objectives of the audit firm set in conducting the audit.					
2. Auditors will be forced to skip audit procedures if the audit time allocated is inadequate.					
3. The audit firm sets audit time budget based on the nature and extent of the audit procedures to be performed irrespective of the audit fee to be charged.					
4. The audit firm sets audit time budget based on the qualification and experience of members of the engagement team irrespective of the audit fee to be charged.					
D. Audit fee					
1. The audit firm determines audit fees based on the time required to undertake the audit.					
2. The audit firm determines audit fees based on the number and competency of the members of the engagement team to be assigned to undertake the audit.					
3. Audit firms must not charge low audit fees with a view to getting new auditees.					
4. Audit firm must not charge low audit fees with a view to retaining the					

existing auditees.					
5. Low audit fee can result in allocating less audit time.					
6. Low audit fee can result in assigning less competent audit staffs.					
7. Large audit fee may impair the independence of the audit firm.					
8. Most of the auditees select audit firms mainly based on minimum audit fees quoted.					
E. Audit regulation (Licensing of firms and individuals, designation of law and standards and inspection of audits for quality)					
1. Licensing of firms and individuals to undertake audits motivates auditors to conduct effective audits of financial statements.					
2. The designation of law and standards motivates auditors to conduct effective audits of financial statements.					
3. The inspection of audits for quality motivates auditors to conduct effective audits of financial statements.					
4. Taking disciplinary action in the event of non-compliance with standards and audit failures motivate auditors to conduct effective audits of financial statements.					
5. In Ethiopia, the licensing of firms and individuals to undertake audits is considered effective.					
6. In Ethiopia, the designation of law and standards related to audits is considered effective.					
7. In Ethiopia, the inspection of audits for quality is considered effective.					
8. In Ethiopia, the responsible bodies are considered effective in taking disciplinary actions in the event of non-compliance with standards and audit failures.					
F. Litigation environment					
1. Litigation risk (a condition in which an audit firm is required to compensate a litigant for the consequences on an audit failure) will improve audit quality.					

2. The audit firm has been facing litigation risk.					
G. Perceived audit quality					
1. Audit quality is considered achieved when an engagement team applies a rigorous audit process that complied with law and applicable standards such as ISAs.					
2. Audit quality is considered achieved when an engagement team applies quality management/control procedures that complied with law and applicable standards such as ISQMs.					
3. Audit quality is considered achieved when an engagement team obtains reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.					
4. Audit quality is considered achieved when the audit firm expresses an appropriate audit opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.					
5. Audit quality is considered achieved when the audit firm reports on the financial statements, and communicate as required by the audit standards such as ISAs and other applicable law (legal and regulatory requirements), in accordance with its findings.					
6. Audit quality can be measured by the improvements in the auditees' financial reporting practices, which may result from the audit firm's findings.					
7. Audit quality can be measured by the improvements in the auditee's internal control system, which may result from the audit firm's findings.					
8. Audit quality can be measured by the timeliness of the audit reports issued.					

Appendix 2: Instrument Set B: Questionnaire for a staff of the Accounting and Auditing Board of Ethiopia (AABE) and leaders of the Ethiopian professional associations of accountants and auditors

Belete Tensaye Wakeyo,

MBA student at Addis Ababa University

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E-mail: **wtensayebelete@gmail.com**

1 March 2024

Dear Sir/Madam:

The enclosed questionnaire is designed to gather information about quality of the audit of financial statements in Ethiopia. The questionnaire has been sent to a staff of ABBE and 3 leaders of the Ethiopian professional associations of accountants and auditors in Addis Ababa, Ethiopia. The information you provide in response to the items in the questionnaire will be used as part of the data needed for a study on *Factors Affecting Perceived Quality of Financial Statements Audit in Ethiopia: Implications for Managers of Ethiopian Businesses*. The study is being conducted by the undersigned researcher in partial fulfillment of the requirements for the Master of Business Administration at Addis Ababa University, Ethiopia. The results of the study are expected to contribute to the audit profession (audit theory and practice) in the understanding of factors affecting perceived quality of the audit of financial statements in Ethiopia and the implications of the quality of the audit for business managers.

The questionnaire is anonymous; please do not write your name on it. The conclusions of the study will be drawn in aggregate terms, without any reference to specific individual respondents. I would also like to assure you that the information you provide will be accessible only to the undersigned researcher only.

Further, I would like to advise that participation in this survey is completely voluntary. Nevertheless, your participation is regarded as a valuable assistance. I believe that you will extend your assistance by participating in the study.

If you have any questions about this survey, please do not hesitate to contact me using my phone number 0911478963 or via my email address: wtensayebelete@gmail.com.

Thank you for your participation.

Kind regards,

Belete Tensaye

General Instruction: This questionnaire contains 3 pages and is expected to take about 45 minutes of your time to complete. Please provide your responses to the questions based on the instructions under each section.

Section I: General questions

Gender (Please indicate your choice by putting the mark X in the space below your response option)

Male	Female

2. Age (Please indicate your choice by putting the mark X in the space below your response option)

18 – 35	36- 45	46- 55	>55

3. Your qualification (Please indicate your choice by putting the mark X in the space below your response option. You can choose more than one option if applicable)

Diploma	Bachelor's Degree	Master's Degree	PhD	ACCA	CPA	CIMA	CIA	Other

Your current position/status in the entity/association (Please indicate your choice by putting the mark X in the space below your response option)

Director	Deputy Director	President	Vice President

5. Work experience in audit and/or accounting fields in years: _____

6. Work experience in other fields in years: _____

Section II – Factors affecting perceived quality of the audit of financial statements in Ethiopia and implications of perceived quality for business managers

Instruction: Below are statements pertaining to a) the factors affecting perceived quality of the audit of financial statements (audit quality) in Ethiopia at each audit engagement, audit firm and national (country) levels, and b) perceived audit quality. Please provide your answers for each question in the spaces provided.

A. Audit firms' size

1. How do you rate the audit firms in Ethiopia in terms of their size taking the number of their qualified (ACCA and/or CPA) and experienced audit staffs and audit clients (auditees) into consideration?

2. Does the size of an audit firm have impact on its ability of achieving the objectives it set in conducting the audit of financial statements?

3. If you believe that most of the audit firms are considered small in size, which has negative impact on the quality of the audit of financial statements, what should the regulators, auditors/audit firms and auditees do to rectify the problem?

4. Are audit firms formed as partnerships more capable of achieving the objectives they set in conducting the audits of financial statements than those formed as sole proprietorships?

5. If you believe that partnerships have more capacity than sole proprietorships, what should the regulators, auditors/audit firms and auditees do to increase the number of partnerships?

B. Audit time (Time allocated for auditors to perform the audit)

1. Do you think that sufficient audit time must be allocated for the auditors to conduct the audit in order to achieve the objectives of the audit firm set in conducting the audits of financial statements?

2. Do you think that auditors will be forced to skip audit procedures if the audit time allocated is inadequate?

3. Do you think that audit firms set audit time budget based on the nature and extent of the audit procedures to be performed and taking the qualification and experience of members of the engagement team into consideration irrespective of the audit fee to be charged?

C. Audit fee

1. a) Do you agree with the existing general notion that the audit fees charged by most of the audit firms in Ethiopia are low because the auditees select auditors mainly based on low audit fees quoted which trigger audit firms to offer low audit fees and the auditors want to retain the existing auditees? b) If you agree, what should the regulators, auditors, audit clients and those charged with governance of the auditees, including audit committees do to rectify the problem?

D. Audit regulation

1. What are the roles which those charged with governance of the auditees, including audit committees in Ethiopia can play towards the conduct of effective audits?

2. If you think that those charged with governance of the auditees, including audit committees in Ethiopia are not playing their roles in the conduct of effective audits, who should do what to rectify the problem?

3. Is the audit regulation in Ethiopia, which involves the licensing of firms and individuals to undertake audits, the designation of law and standards, the inspection of audits for quality, and disciplinary action in the event of non-compliance with standards and audit failures, effective in motivating auditors to conduct effective audits of financial statements?

4. If you think that the audit regulation is ineffective, (a) Who do you think are the responsible bodies and what are the reasons behind? (b) Who should do what to rectify the problems?

E. Litigation environment

1. Are audit firms in Ethiopia not facing a litigation risk (a condition in which an audit firm is required to compensate a litigant for the consequences on an audit failure) which could help to improve audit quality?

2. If you think that currently there is no litigation risk which audit firms face, (a) What do you think are the reasons behind? (b) Who should do what to establish a litigation environment?

F. Perceived audit quality

1. What do you think are the criteria used to measure audit quality?