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COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

Effectiveness of audit practice in improving financial performance in the case of
selected private organisations in Addis Ababa

A Research Project Submitted to Addis Ababa University College of Business and
Economics, Department of Accounting and Finance, in Partial Fulfilment of the
Requirements for the Degree of Masters in Accounting and Auditing

By:

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JUNE, 2024

Addis Ababa, Ethiopia

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DECLARATION

I hereby affirm that the title "Effectiveness of audit practice in improving financial performance in the case of selected private organisations in Addis Ababa " is presented to partially meet the requirements for attaining a master's degree in accounting and auditing. The study represents the culmination of my endeavours and has not been previously submitted for any academic credential in this or any other educational institution. All references utilized in this study are appropriately acknowledged in adherence to scholarly conventions, and the dissertation is executed autonomously under the supervision and counsel of my academic advisor.

Signed:  Date: 17/09/2024

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This research project has been submitted for examination with my approval as the university supervisor.

Signed:  Date: 17/08/2024

Dr. Temesgen W

Statement of Certification

This is to declare that the project titled " Effectiveness of audit practice in improving financial performance in the case of selected private organisations in Addis Ababa," prepared by Assefa Belaynew, fulfils the requirements for the Master's Degree in Accounting and Auditing. It also complies with the University regulations and meets the accepted standards for originality and quality.

Approved by:

Temesgen Worku



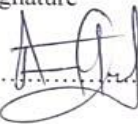
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DEDICATION

I am dedicating this project to my family and friends in particular to my father, who has been a pillar and inspiration throughout my life.

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LIST OF ABBREVIATIONS

ACCA	Association of Chartered Certified Accountants
CAATs	Computer Assisted Audit Techniques
IAASB	International Auditing and Assurance Standards
IAS	International Auditing Standards
ISQC	International Standard on Quality Control
ROA	Return on Assets
ROE	Return on Equity
ROS	Return on Sales
SPSS	Statistical Package of Social Sciences

ABSTRACT

The objective of this study was to find out the Effectiveness of audit practices in improving financial performance in the case of selected private organisations in Addis Ababa. The project was conducted among the 40 Addis Ababa city government private companies. This study used descriptive and inference research designs. The sample was administered a structured questionnaire to collect primary data. Secondary sources of data include other research and projects before interviews with some experts. The data were analyzed with a statistical package of social sciences (S.P.S.S.). The study concluded that the relationship between financial performance and audit quality is positive and significant. In particular, the study found negative relationships with the provision of non-audit services and positive links between financial performance and compliance with audit standards, the independence of auditors and the professional qualifications and experience of auditors. The research recommends that private organizations pay attention to the quality of the audit they receive from external auditors, as the results have shown that it affects financial performance. The study recommended further research into the definition and measurement of audit quality.

Key Words: External Audit, External Audit Functions, Improvement of Financial performance, Private sectors.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

According to the Institute of Chartered Accountants in England and Wales (ICAEW), 2005, an external audit strengthens public confidence in financial reporting by enforcing accountability and providing clarity. This serves an essential financial purpose. Additionally, auditing guarantees that the various stakeholders in a corporation are concerned. Stakeholders expect external auditors to enhance the reliability of financial statements by ensuring that the information contained therein is free from material errors and fraud, as audits are conducted by independent and professionally competent auditors with a solid understanding of the company's operations and financial reporting requirements (Dawkins, 2015). The quality of audits is known to impact financial reporting and significantly influence investors' confidence in the management of the company. This provides stakeholders with reasonable assurance that their investments are secure and serves as a deterrent to management from manipulating financial reports. Audit quality enhances firms' financial performance by attracting new investors and retaining existing ones due to the high prospects of financial growth.

Various theories have been developed to justify the necessity of audit functions. The agency theory is a significant financial concept that emphasizes the need for accountability, which forms the basis for the establishment and development of audits (ICAEW, 2005). This theory addresses the inherent conflict of interest between shareholders and the management of a company. The credibility theory suggests that stakeholders' confidence in the management's stewardship of the company is enhanced through the audit of financial statements (Mahdi, 2011). The theory of inspired confidence posits that stakeholders demand management accountability in exchange for their commitment to the company. According to this theory,

auditors are expected to fulfil their duties by the general audit standards set by a rational third party.

External auditing is governed by organizations designed to ensure that work is carried out competently and following established guidelines. To increase public confidence in the audit process and financial reporting, these 43 regulatory agencies have to uphold the quality of audits. When the audits that audit companies perform are of unquestionable quality, they will be in a better position. Despite this wish, audit quality is frequently found to be below par when regulatory organizations undertake reviews on the conduct of audit work (Association of Chartered Certified Accountants (ACCA), 2015). The failure to do so drives home the importance of audit quality and its role in maintaining the stability of the financial markets. It has also emphasized the role of high audit quality in fostering overall market confidence. This study aims to contribute to the growing body of literature on audit quality and financial performance and encourages further research on the subject.

1.1.1 External Audit Quality

The cumulative likelihood that an independent auditor would find and disclose a substantial misrepresentation in the client's financial statements is what DeAngelo (1981) describes as audit quality. This definition states that an auditor's competency influences the likelihood that they will find a misstatement, and their independence decides whether or not they will disclose it. Qualitative characteristics, such as an auditor's ability to exercise professional scepticism and make objective decisions during the audit process, are indicators of an auditor's independence (Hooper, Fornelli, & Chipman, 2016). The knowledge, abilities, attitudes, and behaviours of the engagement team that allow them to carry out the audit task in an appropriate manner demonstrate the auditor's competence.

To achieve audit quality, the Institute of Auditing and Assurance Standards Board (IAASB) emphasizes the importance of creating an environment that promotes quality at the engagement group, firm, and national levels. The audit work should be conducted independently, competently, and with a collaborative approach between the auditor and the company's representatives. Audit quality can be assessed from three key perspectives: input, output, and contextual issues (IAASB, 2015). Input requires auditors to possess appropriate values, attitudes, ethics, and skills, along with sound knowledge and experience. Auditors should also allocate sufficient time to perform the audit work. The audit process should be thorough and follow quality control procedures that comply with regulations, standards, and laws. The outcome of a quality audit process is the production of significant and timely reports. While the auditor bears the responsibility for audit quality, it is best achieved in a supportive environment that fosters open communication among the various participants in the financial reporting supply chain.

Audit quality plays a crucial role in the operations of commercial banks as it serves as a key indicator of the effectiveness of management's oversight. Enhanced audit quality not only boosts stakeholders' and the public's confidence in the financial reports prepared by management but also reduces the expectation gap (ACCA, 2015). Moreover, it mitigates audit risks and minimizes the likelihood of the audit firm delivering an incorrect audit opinion. The significance of audit quality is underscored by the attention it receives from regulatory bodies, audit firms, and various organizations (IAASB, 2015). For instance, IAASB has established an audit quality framework to highlight key aspects of audit quality, enabling stakeholders to assess ways to enhance audit quality and fostering dialogue among stakeholders on the subject. Additionally, the Board has introduced two quality control standards to uphold audit quality: ISQC 1 and IAS 220. IAASB and other regulatory bodies, like the UK Financial Reporting

Council, are responsible for upholding audit quality to bolster public confidence in audit functions and financial reporting.

Nowadays, audit quality is considered the independent variable, and due to the intangible nature of its components, it has been evaluated through four quality proxies, including auditor independence, professional expertise, provision of non-audit services, and adherence to auditing standards.

1.1.2 Financial Performance

Financial performance is the level of achievement or achievement of a financial goal expressed in monetary terms. It is a tool used to evaluate the results of company strategies and operations using financial metrics (Wangithi, Njangiru and Ngungu, 2016). This includes assessing the results of a company over a certain period, comparing the performance of several companies in the same industry, or comparing different sectors or industries in an economy. Financial statements are the main sources of information and are used to communicate company financial results to internal and external stakeholders (Brooks, 2013). They provide information on the financial situation of a particular company, the results of its activities and changes in the financial situation over a specific period (Dawkins, 2015). These financial statements provide insight into the company's financial performance over time and enable future financial projections.

Since banks play an important role in the national economy, which depends heavily on banking stability, it is difficult to understate the importance of strong financial performance for commercial banks. Common indicators for measuring financial performance include asset, investment, equity, sales, and gross profit margin (GPM). These percentages are used to evaluate profitability, reflecting the efficiency of generating income from sales or assets. In

this study, financial performance was evaluated as a dependent variable using asset return (ROA), which is commonly used in industry and commercial banks.

1.1.3 Quality of External Audit and Financial Performance

In today's economy, information and accountability are crucial. Therefore, the data provided by companies must be accurate and reliable. This underscores the importance of high-quality external audits of a firm's financial statements, as stakeholders rely on this information to make informed economic decisions. Audit quality increases users' confidence that the financial information presented in the statements is free from material misstatements and fraud, as auditors are unbiased professionals with knowledge of the company's operations and financial reporting standards (Dawkins, 2015). The significance of high audit quality in ensuring financial market integrity is highlighted by the failures of prominent companies such as Enron and WorldCom. These incidents have underscored the importance of reliable financial reporting for a healthy financial environment, with high-quality audits enhancing market confidence (Martinov-Bennie, 2014).

1.2 Statement of the Problem

In the present financial environment, the need for external audits is driven by the dissemination of financial data to different stakeholders. Risk management is the main focus of external auditors because risks that could have an adverse effect on a company can influence the financial statements, audit planning, and audit execution (Knechel, Salterio & Ballou, 2007).

The work of external auditors has been subject to heavy criticism, primarily for perceived shortcomings in performing expected duties or meeting required standards. Auditors have been accused of performing low-quality reviews because they lack professional competence and independence, don't devote enough time to the audit process, and don't follow pertinent guidelines and regulations. Several reports have emphasized the lack of confidence in the work

of external auditors, which has resulted in a decline in society's trust in the audit profession as a whole and raised doubts about the abilities of auditors (Porter & Gowthorpe, 2004). These negative perceptions are caused by a mismatch between society's expectations of audit work and what auditors deliver, known as the "audit expectation-performance gaps" (Porter, Baskerville & Hogartaigh, 2012).

Financial statements are narratives, and through careful examination and analysis, it was discovered that these narratives did not add up. In 2001, it became apparent that the management of WorldCom and Enron had engaged in questionable accounting practices and deceptive financial reporting to manipulate their financial statements to show growth and profitability when, in fact, they were losing money. The collapse of well-known corporations such as Enron, Parmalat, Xerox, Cable and Wireless, and WorldCom, which had been experiencing strong financial performance throughout the 1990s, raised concerns about the dependability of audit work.

1.3 Research Questions

- a) What is the impact of auditor independence in improving the financial performance of private companies?
- b) How do external audit standards increase the performance of companies' financial performance situations?
- c) How professional competence and experience of auditors affect the financial performance of private companies?
- d) How does the provision of non-audit help improve financial performance?

1.4 Objectives of the Study

1.4.1 General Objective

To determine the effectiveness of audit practice in improving financial performance in the case of some selected private companies in Addis Ababa city Administration.

1.4.2 Specific Objectives

1. To identify the impact of auditors' independence on improving companies' financial performance.
2. To examine how external audit standards increase the performance of private companies' financial situation.
3. To assess how the professional competence and experience of auditors affect the financial performance of private companies.
4. To examine how provision on non-audit helps improve the financial performance of the companies.

1.5 Significance of the study

The project gave another insight into the effectiveness of audit reports and their impact on the performance of different companies residing in Addis Ababa. This will help other researchers, financial managers, owners and other stakeholders to determine their audit report against the financial performance of their company.

For researchers, it will be another aid in their pursuit of a new dimension of auditing and financial performance.

1.6 Scope and Delimitation of the Study

Since it is a project, I tried to put a greater emphasis on a few multifunctional companies (i.e., those invested in different business areas) that can define the purpose of the project.

So, the scope of the project is limited to a few companies participating in different business areas in Addis Ababa. The companies included Manufacturers, service providers, retailers and import exporters.

1.7 Limitations of the study

Time and resource limitations are two of the study's main limitations. Additionally, the study will only include the data that respondents were willing to share. It makes sense that this will restrict the study's conclusions. As a result, there won't be many literary publications on the topic, and the research will review the already available handful. A further constraint that the researcher faced was time constraints. Another constraint was the absence of adequate funding to carry out a thorough investigation.

1.8 Organization of the Research Paper

The research paper is organized into five chapters. The first chapter introduces the background information, statement of the problem, research questions, general and specific objectives and significance of the study. It also includes the scope and limitations of the research. Chapter two introduces a review of relevant literature related to the research problems and objectives of the study. Chapter three discusses the research design adopted for the research and outlines the methodology for carrying out primary data collection. Chapter four presents the findings of the research along with the researcher's analysis and interpretation of the respondents' opinions. Chapter five covers a discussion of a summary of the major findings, conclusions and recommendations.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1. Introduction

The evolution and development of audit, theories that currently exist to support the need for an audit function, and a review of the literature developed on the subject by various authors are the main topics of this chapter. Books, journal articles, and previous research conducted in the field are among the literature sources reviewed. Empirical studies conducted in the field of study are also presented in this chapter, which is concluded with the conceptual framework that guided the empirical study.

2.2. Evolution of Auditing

The earliest known accounts of auditing come from the Mesopotamian civilization, which flourished around 3500 BC. They understood how crucial it was to safeguard both public and private property. There were multiple indicators in the financial transaction records at the time that pointed to the existence of internal controls, a system of verification, and a division of labour. The "hearing of accounts" method was employed in ancient Rome, wherein an official would compare his records with those of another. This approach makes use of verification processes in addition to separation of duties. The Latin word "Audire," which means to listen, is where the word "audit" first appeared.

The European Industrial Revolution in the Middle Ages changed the role of auditing. In addition to hearing accounts, the process now involved confirming accounting records and associated supporting documentation. Internal audits swiftly shifted their emphasis from primarily addressing financial and accounting issues to encompassing the entire range of operational activities following World War II.

It is expected of many government agencies to have both an audit committee composed of directors who are not in management and an internal auditing department. The field of internal auditing has advanced as a result of these developments. The main causes of these developments are the growing size and decentralization of organizations, the complexity of their operations, and the consequent demand for tools for activity monitoring. (Irvin, Gliem, 2000).

2.3. Development of Auditing

HISTORICAL BACKGROUND OF AUDITING

The word "audit" comes from the Latin verb *audire*, which means "to hear" or "to listen.". Auditing, according to Flint (1988), is a social phenomenon with only a utilitarian existence and no intrinsic value beyond its practical usefulness. Wang (2004) defined financial audit as the process of reinforcing one's self-identity, self-measurement, and self-edit on the financial accountability of management. To express an opinion about the advantages and viability, an audit typically entails looking over and confirming data, registers, procedures, and circuits, according to Cañibano (1993). Auditing is a method to look at what you do and see if there is a way to improve patient care.

Power (1999) defined auditing as the systematic, unbiased examination of a company's books, accounts, records, and vouchers to ascertain the degree to which the financial statements fairly and accurately represent the matter under consideration. Raffa (2003) defines auditing as a systematic process that collects and impartially evaluates data regarding assertions made regarding economic activities and events to ascertain the degree of correspondence between those assertions and predetermined criteria. The interested parties are then informed of the results.

The history of Auditing has greatly influenced the history of auditing, as the latter changed and concluded as the global economy progressed (Tanko, 2011). Salehi (2008) observed that although the ancient societies of Egypt, Greece, Italy, and Mesopotamia seem to be proof of deeply established financial structures, the financial reality of these eras was limited to the documentation of individual transactions. Salisu (2011) observed those archaeological artefacts and findings, which revealed that bookkeepers were the ones who composed the content.

Lee (1994) observed that there is generally a lack of documentation regarding the early documented improvements in inspecting. Inspection in the form of antiquated checking exercises was present in ancient Egypt, Greece, and China (Lee, 1986; Boyd, 1905). The outdated verification rituals discovered in Greece (c. 350 B.C.) appear to be the most comparable to the current assessment. Comparable forms of oversight were also present in the outdated British Exchequer. To establish beyond a reasonable doubt that the state's income and use exchanges were properly accounted for, special review officers were appointed when the Exchequer was established in Britain during the reign of Henry 1 (1100-1135) (Gul et al. 1994). The term "auditor" refers to the person qualified to examine accounts. The purpose of this examination was to prevent fraudulent activity (Abdel-Qader, 2002).

Furthermore, it was discovered that the Italian City States engaged in checking exercises. Reviewers were employed by the vendors in Florence, Genoa, and Venice to help them verify the wealth that sailing ship captains returning from the Old World and headed for the European Landmass brought with them. According to Brown (1992), the reviews conducted in the City of Pisa in 1394 were somewhat similar to those conducted in the Italian City State. This suggested that the reviews were meant to verify the claims made by government officials to determine whether or not deception had occurred.

2.4. Theoretical Review

Three theories were examined in this study: agency theory, the theory of inspired confidence, and the theory of lending credibility. These theories explain what stakeholders expect from the auditors, such as assurances regarding the firm's financial stability, fraud protection, early warning signs of impending insolvency, preservation of auditor independence, and the ability to understand audit reports (Volosin, 2008).

2.4.1. Agency Theory

Agency theory focuses on resolving issues that can arise in agency relationships, specifically between principals (such as shareholders) and agents (such as company executives) who act on behalf of the principals. There are two main problems that agency theory addresses. The first is when the goals or desires of the principal and agent conflict, and the principal cannot verify the agent's actions. The second problem occurs when the principal and agent have different attitudes towards risk, leading them to take different actions.

According to Adams (1994), agency theory can contribute to more comprehensive research in the field of internal auditing. It suggests that internal auditing, along with other mechanisms like financial reporting and external audit, plays a role in maintaining cost-efficient contracts between owners and managers. Agency theory not only helps explain the presence of internal audit in organisations but also sheds light on certain characteristics of the internal audit department, such as its size and the scope of its activities (e.g., financial versus operational auditing). By employing agency theory, researchers can empirically examine how variations in internal auditing practices reflect different contracting relationships resulting from organisational differences.

Understanding how the auditor's role is established requires an understanding of the relationship between the principal and the agent. The auditor is employed by the principal, who

also gives them some decision-making authority. Therefore, to maximize the firm's benefit, the principal depends on the auditor to carry out their duties. Auditing ensures that the financial statements prepared by management are free of material errors, which helps to minimize data imbalances and safeguard the interests of all parties. The study that is being presented here makes use of organization theory to explain why an independent audit of financial statements is required as a contractual response to potential conflicts that may arise in the relationship between managers and owners, at the lowest possible cost.

2.4.2. The Lending Credibility Theory

Volosin (2007) discusses in his book the lending credibility theory, which is similar to the agency theory. According to this theory, audited financial statements play a crucial role in enhancing stakeholders' trust in management's stewardship. In the business world, various groups are impacted by or involved in the financial reporting requirements set by regulatory agencies. These groups include shareholders, managers, creditors, employees, government, and others. Among these, shareholders, including both individual investors and large institutions like banks or insurance companies, are the primary recipients of annual reports. Their decision-making process is often influenced by the financial reporting and the performance of the company's management, who have a fiduciary duty to act in the best interests of investors. Therefore, the purpose of financial statements is to serve these objectives.

The appointment of an auditor is made by the company's shareholders, and the auditor reports the findings to their clients. The main objective of the auditor's report is to provide an assessment of the accuracy of the company's financial presentation and its performance. This serves to reassure shareholders that their investments are secure and also helps to discourage the use of misleading accounting practices aimed at portraying the company in a more

favourable light. Essentially, the audit process is designed to evaluate the credibility of a company's financial statements (Letza, 1996).

2.4.3. Theory of Inspired Confidence

The purpose of an audit is to assess the reliability of a company's information, policies, practices, and procedures. While certain financial institutions are required by government regulations to undergo independent financial audits, audits can also be mandated in other areas such as safety and technology based on industry standards. Regardless of the subject of the audit, several factors can influence a company's final results, and these factors are taken into consideration during the audit process according to the contingency theory.

The contingency theory of leadership and management states that there is no one-size-fits-all approach to leading, controlling, and managing organizations. Organizations' functioning and processes depend on various internal and external factors. Audits themselves are a type of organizational function that is influenced by different factors in the environment. This is why the contingency theory is applied to manage audits, recognizing that the processes and outcomes of audits are dependent on variable and contingent factors.

At a high level, the audit process is straightforward. Auditors need access to documents, systems, policies, and procedures to conduct an audit. They must adhere to industry standards, government regulations, and internal requirements. The audit teams typically start with meetings to gather information about risks and controls, and then proceed with field work. During the audit process, auditors perform substantive procedures and test controls. They then prepare reports that are submitted to management and regulatory authorities. The audit sub-processes, particularly in planning and fieldwork, involve contingencies such as the type of business, the skill level of employees, relevant laws, the availability of audit resources, technology and systems, and deadlines.

In his book, Daft (2012) explains that contingency theory emphasizes the interdependence of various factors. This theory applies to audit functions, which are task-oriented and can have a flexible structure. The nature of audit functions can vary depending on the specific area of a company being audited and the type of business model. Therefore, auditors need to carefully manage their inspections and consider different variables to complete their tasks. The contingency theory can also be applied to the structure of an audit team. Typically, audit team managers assign audit projects and form ad hoc teams based on the auditors' expertise, experience, and availability. These factors create contingencies for each audit project.

To ensure efficient and effective outcomes, audit teams utilize a combination of structure and contingency. Auditing projects can encompass a wide range of areas, such as evaluating production processes, examining company accounts, and assessing compliance with industry standards. By selecting auditors with specialized training or specific skills in the relevant subject area, the learning curve is minimized and the likelihood of errors is reduced. The quality and output of audits are maintained when audit teams allocate resources based on expertise and experience, and when auditors demonstrate flexibility and adaptability to fluctuations in the auditing process. For instance, an auditor with experience in evaluating financial instruments can effectively conduct an audit for a bank or hedge fund, even if the financial instruments offered by the institution deviate from the norm (Davoren, 1994).

ENRON'S CASE AND EVOLUTION OF AUDITING

The Enron Corporation, a U.S. energy company based in Houston, went bankrupt in October 2001 due to the Enron scandal, leading to the closure of Arthur Andersen, a top global audit and accounting firm.

Enron was simultaneously the largest audit failure and the most significant bankruptcy

reorganization in American history. Enron was established by Kenneth Lay in 1985 after the combination of InterNorth and Houston Natural Gas. A few years later, Jeffrey Skilling was brought on board and put together a team of executives who hid large amounts of debt from failed business projects and investments through the use of special purpose entities, accounting tricks, and inadequate financial reporting. Enron's CFO, Andrew Fastow, along with other executives, deceived the audit committee and board of directors about risky accounting issues and forced Andersen to overlook them.

Enron's stock price reached a high of \$90 per share in mid-2000 but plummeted to under \$1 by the end of November 2001, causing shareholders to suffer a loss of nearly \$11 billion. Following an inquiry by the SEC, Dynegy proposed purchasing the company at a significant markdown. Enron held the title of the biggest corporate bankruptcy in US history until WorldCom's bankruptcy in 2002, which involved \$63.4 billion in assets.

Multiple Enron executives were sent to jail following allegations of different crimes. The US District Court found Enron's auditor, Arthur Andersen, guilty. However, when the decision was overturned by the US Supreme Court, the company had already shut down and lost most of its clients (refer to Arthur Andersen LLP v. USA). Employees and shareholders suffered significant financial losses in terms of profits and stock prices, with only a fraction of their claims being repaid.

During the later years of the 20th century, as skilled bookkeepers were hired by auditing firms, they faced greater competition to cut their review expenses or face losing clients to rival firms. The review was considered a non-unique product due to restrictions in the law that only allowed the review opinion to be published in a generic format. However, it also gave the review company a concrete method to determine if its service offerings would decrease costs compared to competitors or offer extra services besides the audit. The review companies

developed, delivered, and supplied more profitable non-audit services connected to existing review partnerships as a viable financial solution to the increasing price competition.

Andersen's biggest accomplishment at Enron was in this specific area. Andersen's success in selling its administration services to Enron resulted in the necessity to protect its independence as an auditor as Enron's issues became well-known. If Andersen had not received additional, more beneficial incentives, it is possible that it would not have considered the risks associated with its inspection relationship with Enron to be worth taking. The criticism of the unused rules and regulations established to improve the reliability of financial reporting for public companies could have resulted in Andersen having no choice but to either stop providing non-audit services to Enron or raise the audit fee considerably.

The Sarbanes-Oxley Act increased consequences for tampering with or manipulating records in government investigations or trying to deceive shareholders. The legislation also raised the responsibility of auditing companies to uphold objectivity and independence from their clients. After Enron's downfall, the Sarbanes-Oxley Act was implemented. It explains the criteria for reviewer independence, quality control procedures for reviews, changes in audit partner roles, and how to prevent conflicts of interest situations. Moreover, the act also requires.

2.5. Auditing and Financial Management

In the last decade, there has been an increasing emphasis on coordinating internal and external review processes. Robust corporate governance frameworks can reduce the negative impacts of company failures or bankruptcies, as noted by Rusak and Johnson (2007). Internal auditing is commonly recognized as having a major impact on improving the quality of financial reporting. The Blue Lacey Committee Report (1999) explains that internal and external audit functions, along with audit committees of boards of directors, are essential for corporate

governance and ensuring the credibility of financial reporting.

The utilization of financial data by boards, along with internal and external audit contributions, gives insight into the current connections within corporate governance, benefiting management in decision-making. This input from shareholders and management is supported by various sources (Fan and Wong 2004, Jensen and Meckling 1976, Blue Lacey Committee, 1999).

The effectiveness of audit committees, an important tool that supports boards, is improved by the activities of both internal and external audits (DeZoort et al. 2002). Within the context of corporate governance, the internal audit is a vital resource that aids the other elements (Gramling et al. 2004; DeZoort and Associates). (2002)). However, there is still a lack of understanding about the importance of audit components in the creation of national corporate governance systems.

Through observational studies conducted in developing nations, Fan and Wong (2004) demonstrate the role of external evaluation in corporate governance in developing economies. Nevertheless, little research has been conducted on the connections between corporate governance and internal and external audit activities in developing countries. The effective review guidelines, known as the International Standards on Auditing (ISA) 610, offer instructions for external auditors conducting financial statement reviews.

The article highlights how the inside review movement's reliance on external reviewers is causing a decrease in investment funds due to the decreased time spent on preparing for outside reviews. Outside reviewers monitor the actions of inside reviewers to assess the credibility of their work. This guarantee is crucial, as internal auditing can reduce costs for the company and add significant value (Krishnamoorthy 2001, 2002; Morrill and Morrill, 2003; Mihret 2010; Mihret, James and Mula 2010).

Certainly, the opportunity to reduce costs sparks the curiosity of the other two crucial aspects of corporate governance (management and CEO boards), which are eager to promote continued

cooperation between internal and external audits. The aim to decrease external audit costs, manage expenses, and enhance competitiveness drives external auditors to depend on the work of internal auditors (Morrill and Morrill, 2003). Additionally, internal inspectors can offer detailed information about organizations to help external reviewers minimize review risks at the organizational level. Meanwhile, examined financial statements are a crucial resource that investors can use to evaluate the accuracy of financial declarations and as a basis for making decisions on asset allocation.

In any capital advertising, it is essential to have freedom and review quality to enhance clarity, precision, and straightforwardness in budgetary detailing. For investors to allocate assets properly, reviewing companies must always deliver review reports quickly (Dahawy and Samaha, 2010). A delay in sharing the auditor's assessment of the accuracy of financial information prepared by the company's management disrupts the data that directors provide to shareholders and harms them.

In organization theory, the examining committee is seen as a "tool" that enhances the quality of communication between the substance owners and its management, especially in financial reports, where their information levels vary greatly.

Nevertheless, the external auditor's crucial role in enhancing corporate governance effectiveness lies in improving the accuracy of financial statements through enhanced validity (Francis et al. (2003) and Sloan (2001)). This suggests that external auditors were sometimes seen as the "guardians" overseeing administrative conduct for everyone involved (O'Sullivan et al. 2008). The absence of proper corporate governance structures could put their maintenance at risk (Coffee, 2001).

According to the office hypothesis, major audit firms play a role in improving the quality of disclosed information and helping decrease office expenses and data asymmetry. They also

restrict smart management behaviour by monitoring, thereby guaranteeing investors' safety.

The writing's review quality was routinely assessed using the review firm measure, with support from various studies, to potentially enhance corporate governance practices among organizations.

The high quality of review services offered when compared to small companies, as noted by Leung and Horwitz (2010); overall, "there's more at stake" in major entities (Color, 1993). The increased review costs, extended audit durations, and reduced number of forms can be mostly attributed to this.

Furthermore, there is a known track record of reducing mistakes as supported by various studies (DeAngelo, 1981; Beatty, 1989; Firth, 1979; Chow, 1982; Ahmed and Nicolis, 1994). Big auditing companies are more inclined to put in extra effort to uphold their reputation as top-tier service providers because they have more to lose compared to smaller companies if their reputation is tarnished. More extensive knowledge is usually shown through behaviours that motivate authorities to share as many details as they can to lessen data imbalance and organizational expenses (Baiman, et al. Baiman (1990); Wallace et al. (1987). 1994; Watts and Zimmerman, 1986; Watts, 1977).

Due to their extensive customer base, the added independence may not affect the quality of their work as significantly as it would for smaller evaluation companies (Owusu-Ansah, 1998). Their autonomy enables them to impact corporate financial reporting to meet the needs of

external stakeholders, as they enhance the quality and quantity of disclosed data (Barako et al. 2006).

2.6. Empirical Review and Gap

There is very little empirical data on this subject from studies done in impoverished nations, particularly Ethiopia. The raw data (respondents), profession, and approach (direct or indirect) are not comparable in research papers on the topic published overseas. Variables have also been considered differently, and the analysis process is entirely different. Suyono (2012), for instance, employs independence, experience, and accountability as factors. Three ways are used to form the problem: the simultaneous, somewhat related, or dominant effect of these variables on audit. The central Java and Jogiakarta provinces of Indonesia serve as the source of data for all respondents, who are junior auditors employed by a public audit business.

In 2018, Kusumawati, A., and Syamsuddin, S. This thesis examined professional skepticism regarding audit quality as well as determining elements in auditor quality. to look into the connections between professional skepticism and auditor quality using various evaluation techniques. There are two approaches to evaluating the relationship:

1. Scepticism in direct relation to audit quality
2. Being sceptical of audit quality, indirectly auditor quality. By disseminating the questionnaire, the Audit Board of the Republic of Indonesia (BPK) in South Sulawesi Province obtained primary data from the respondents. Partial least square analysis yielded the results.
3. Professional scepticism acts as a mediator between auditor quality and audit quality; auditor quality does not directly affect audit quality. Auditor quality (ethics, commitment, independence, competence, and experience) if these variables are independently assessed might produce different results.

Daniswari, D., Rudyanto, A., and Oktaviani, Y. (2017) This thesis examines whether audit quality is impacted by an auditor's competence or reputation. Auditor competence in terms of audit company reputation, auditor tenure, and audit industry specialization. Manufacturing companies listed between 2013 and 2015 on the Indonesia Stock Exchange comprised the study sample. The source of the secondary data was www.idx.co.id. manufacturing businesses. Partial least squares analysis yielded an outcome that shows that audit quality is independent of auditor competency. Therefore, business reputation or auditor capability have no bearing on the quality of an audit in Indonesia.

Tensae N. (2017) The six independent factors that the researcher takes into account in this thesis are company size, regulation, audit fee, independence, audit experience, and accountability. The target demographic of senior and above level auditors employed by ninety-eight audit firms provided the primary source data. An explanation of the association between each independent variable and audit quality was provided via statistical test analysis. The findings indicated that the four factors—accountability, independence, audit experience, and significance—have a favorable and noteworthy impact on audit quality.

MohdHanefah, M., and F. E. Hussein (2013). Audit firm size, litigation, auditor tenure, non-audit service provision, industry experience, and peer assessment on audit quality are among the variables that affect audit quality. When determining the optimal approach for audit quality, the indirect approach is taken into consideration.

Even in a developing nation, Ethiopia has little research on this topic, according to empirical theories from earlier research publications. Authors who conduct empirical research take into account one or more variables. There are also differences in the working profession, degree of responsibility, and demographic of the respondent or data source. The total of two or more

variables is regarded by the author as a single variable. The same criteria that apply to auditor quality include auditor competency (audit industry specialization and auditor tenure) and auditor quality (ethics, commitment, independence, competence, and experience). Finally, previous research articles have not noticed the variable auditor size effect on audit quality, and the outcome of similar variables differs from the outcome of this study paper.

This study paper focuses on potential explanatory variables which are auditors' independence, external auditors' standards, professional competence and experience and provision of non-audit services. These variables as a factor in providing quality audit service not done. The descriptive analysis explained each variable effect on audit quality service and the effect on companies' financial performance. The Source of data is primary, and all respondents are professional finance officers and managers. This insightful reaction is presumably essential for closing the loop and making a positive impact in this area of the interaction between audit firms and private businesses, as well as how to use high-quality audit reports to boost business financial success. The effects of many variables on the quality of audit services require more research.

2.7. Conceptual Framework

Financial performance was the dependent variable, and capital adequacy was used as the control variable. Proxies of audit quality, such as auditor independence, professional competency, offering non-audit services, and compliance with auditing standards, were the independent variables in the conceptual framework.

Independent Variable

External Audit Quality
◆ External Auditor Independence ◆ External Auditor Professional Competence ◆ Provision of Non-audit Services ◆ Compliance with Auditing Standards

Control Variable
◆ Capital Adequacy

Dependent Variable

Financial Performance
◆ Return on Assets

Figure 2.: Conceptual Framework

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The section deals with the research philosophy, research design, population sampling, research instrument, collection of data and methods of data analysis.

3.2 Research Approach

The research approach for this study used a mixed research approach. Mixed research is a suitable approach for this study because it allows for an in-depth exploration of the research problem. The study used Questionnaire and document analysis as the primary data collection methods. Interviews were conducted with key informants, including Finance managers, internal auditors, Senior Accountants and Higher management officers to get more clarified information about the questionnaires.

3.3 Research Design

This study used a descriptive research design. Because variables can be measured without altering them and because both methods allow us to examine if (and how strongly) they are related, they are ideal for this investigation. The statistical description, agglomeration, and presentation of the relevant constructs or the relationships among these constructs is known as descriptive analysis. Theory testing, or statistical testing of hypotheses, is known as inferential analysis. The purpose of the study was to determine how well audit reports improved financial performance, with a particular focus on a subset of Addis Ababa's private enterprises.

3.4 Data Source & Types

The data sources for this study are primary and secondary. The primary data sources include questionnaires for different professionals in different companies like financial managers, internal

auditors, senior accountants and other managers. The secondary data sources include other research and projects and interviews with some professionals.

3.5 Target Population and Sampling

The target population for this study were private companies in Addis Ababa. The sample of Private companies was selected using purposive sampling. Purposive sampling is appropriate for this study because the selection of the Companies was based on specific criteria. The criteria for selecting the companies included the size of the organization, the number of employees, and the type of activities the organization engages in. The sample size for this study was forty (40) private companies.

3.6 Data Collections

Data for the dependent variable (financial performance) and the control variables (liquidity and capital adequacy) were obtained from questionnaires and interviews. Secondary data was gathered from books and other relevant publications on how audit quality relates to financial performance. The opinions and perceptions on compliance with auditing standards, provision of non-audit services, auditor independence, and professional competence were collected by use of a structured questionnaire. The questionnaires were issued to the finance managers, financial accountants, internal auditors, and even the general managers where the finance manager was not available.

3.7 Data Analysis Methods

The Likert-type scale was used as the rating scale in the questionnaire. The quantitative and qualitative data were edited to identify errors and omissions, and coded—that is, the answers were numerically categorized for efficient analysis, classified into appropriate groups with similar characteristics, summarized, and tabulated. The data were analyzed using multiple regression analysis to determine the relationship between financial performance and external audit quality.

Return on Assets (ROA) was used to evaluate financial performance, which was the dependent variable. The application of auditing standards, auditor independence, professional competence, and provision of non-audit services were used as the independent variables.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.1 Introduction

This chapter focuses on data presentation, analysis, and discussion of the results. The demographic data of the respondents and the response rate are presented in the first two sections. Descriptive and inferential statistics were used to analyse and interpret the results. Descriptive statistics (frequency, percentage, minimum, maximum, and mean analysis) were used to characterise the study variables and demographic features. The relationship between the different independent variables of audit reports and financial performance was predicted using inferential statistics. Multiple linear regression and Pearson correlation analysis were used in the study to determine the relationship between the variables of interest. The joint relationship between independent and dependent variables is specifically ascertained through the application of multiple linear regression analysis. The remaining three sections cover regression analysis and discussion, test for assumptions, correlation analysis, and hypothesis testing.

According to the data collected, all 40 copies of the questionnaires that were sent out were filled out and returned, yielding a response rate of 100%.

4.2 Reliability test

To determine the reliability of surveys with multiple Likert scale questions, use Cronbach's alpha tests. A score of greater than 0 is generally considered acceptable. According to Weisberg (2005), a coefficient of 0.70 may be suitable in some explanatory studies for certain indices, 0.80 or greater in the majority of cases, and 0.90 or greater is almost always acceptable. The researcher examined this literature to assess the validity of the items that were created for the respondents.

Table 1 reliability test

Independent variable and Dependent variable	Cronbach Alpha	NO- of In the scale
External audit standards	.798	4
Auditor independence	.830	5
Professional competence and experience	.846	4
PROVISION OF NON-AUDIT SERVICES	.700	4
Financial performance	.82	3
Overall	0.960	20

Source Spss output, 2023

4.3 Demographic Variables

4.3.1 Gender

Table 2 Gender

Gender	Frequency	Percentage
Male	22	55.0
Female	18	45.0
Total	40	100.0

Source: own survey, 2023

As can be seen from the above table, which represents 55% of all respondents, men make up the majority of respondents. Female respondents make up the remaining 45% of the sample.

4.3.2 Age

Table 3 Age of respondents

Age	Frequency	Percentage
20-30 years	7	17.5
31-40 years	21	52.5
41-50 years	12	30.0
Total	40	100.0

Source: own survey, 2023

According to the data in the above table, the age group comprising the majority of respondents 52 % is 31 to 40 years old. This is followed by 30 % of respondents who fall into the 41 to 50 age group. The remaining 17.5% of respondents indicated that their ages fall between 20 and 30. It is possible to conclude from the data that the majority of the employees fall into the productive age range.

4.3.2. Experience

Table 4 Experience

No of years worked	Frequency	Percentage
1-5	11	27.5
6-10	26	65.0
11-15	3	7.5
Total	40	100.0

Source: own survey, 2023

The majority of respondents, or 65% of all respondents, have six to ten years of experience, as the above table illustrates. A further 27.5 percent of participants stated they have one to five years of professional experience in the industry. The remaining 7.5% of respondents indicated that they

had been in the industry for 11–15 years. It suggests that most respondents have had more positive experiences.

4.4. Descriptive analysis

The frequency, percentage, mean, and standard deviation of the respondents' responses were attempted to be presented in this section of the study. Because it is easier to understand, it attempted to plot the respondents' responses in a descriptive table format. It includes the response's minimum, maximum, mean, and standard deviation. The mean indicates the variable's central tendency, while the standard deviation focuses on how widely the variable values deviate from the mean.

The following mean range criteria are used to find the 5-point Likert-type scale's minimum and maximum length.

Table 5 Mean criteria

No	Mean Range	Response options	Interpretation
1	1,00, 1.80	Strongly disagree	Very low
2	1.80, 2,60	Disagree	Low
3	2.60, 3.40	Neutral	Average
4	3.40, 4.20	Agree	High
5	4.20, 50	Strongly agree	Very high

Source: (Al-Sayaad et.al 2006).

4.4.1. Auditor independence

Table 6 Auditor independence

	Mean	Std. Deviation
There are safeguards in place to regulate the interaction between the auditors and management	2.85	.921
The composition and size of the audit committee is adequate to provide support to the external auditor's work	3.05	.876
The rotation of the senior audit partner complies with the applicable auditing standards	2.67	.971
The auditor's work is guided by a code of ethics	3.70	.911
The external auditor rotation takes place as required by regulations and Standards	3.78	.891
Overall		

Source: own survey, 2023

Five components make up auditor independence, as the table above illustrates. Out of these, the item with the highest mean value, "The external auditor rotation takes place as required by regulation and Standards," is 3.78. This is followed by the item with the lowest mean value, "The auditor's work is guided by a code of ethics," which is 3.70. Both mean values are equivalent, with a mean range of "Agree" based on our criterion. It suggests that the respondents are verifying that the external auditor rotation occurs in accordance with regulatory requirements and that external auditors adhere to an ethical code. According to our criterion, item two (The audit committee's composition and size are sufficient to support the work of the external auditor) has a mean value of 3.05, or a mean range of "Neutral.". Additionally, the mean value of item one (Protections to control the relationship between the auditors and management) is 2.85, which is also in line with

the Neutral response rate. It suggests that the availability of sufficient support for external auditors is not being discreetly confirmed by the respondents. The senior audit partner's rotation complies with the app, as indicated by the lowest mean value of 2.67, which is also equal to a "neutral" level of response rate on item three (the senior audit partner complies with the applicable auditing standards).

4.4.1. External Audit Standards

Table 7 External audit standards

	Mean	Std. Deviation
The external auditor complied with the international auditing standards	2.08	1.439
The effectiveness of the audit resulted from performing the audit work in compliance with the applicable auditing standards	3.65	.662
Compliance with the applicable external auditing standards affects the financial performance of the company	2.85	.921
Complying with auditing standards is a significant contributor to audit Quality	3.13	1.042

Source: own survey, 2023

The variable for external audit standards is comprised of four items. The item with the highest mean value, item two (The effectiveness of the audit resulted from performing the audit work in compliance with the applicable auditing standards), has a value of 3.65. According to our criterion, the mean value corresponds to a "Agree" response rate. The average scores for items three and

four are 2 points⁸⁵ and 3 points¹³, respectively. Item three states that the company's financial performance is impacted by compliance with applicable external auditing standards.

Item four states that compliance with auditing standards significantly contributes to audit quality. With a "neutral" response rate, the two mean values are equal. It suggests that the impact of external auditing standards on the financial performance of companies is not being confirmed by the respondents. The first item, "The external auditor complied with international auditing standards," has the lowest mean value for this variable, 2.08. The response rate of the "Disagree" mean range is corresponding to the mean value. It suggests that those surveyed think there is a discrepancy between internal and external audit standards.

4.4.1. Professional competence

Table 6 PROFESSIONAL COMPETENCE

	Mean	Std. Deviation
The external auditors are Professionally competent to perform the audit function effectively	3.10	1.105
Professional competence is a key consideration when hiring external auditors	2.70	.939
Professional experience is a key consideration when hiring external auditors	2.70	1.067
The external auditor detects and reports fraud and other financial misappropriations	3.28	.905
Overall		

Source: own survey, 2023

As it is observed in the above table Professional competence is constructed from four items. Based on the information all of the mean values are equivalent with a response rate of “Neutral”. It implies that Professional competence-related issues need more attention for better company financial performance.

4.4.1. Provision of non-audit services

Table 9 Provision of non-audit services

	Mean	Std. Deviation
Besides the audit of financial statements, the external auditors also provide non-audit services to the Company	2.85	.921
A different department of the firm provides non-audit services	3.82	.905
There are proper safeguards in place to check against possible conflicts of interest	2.88	.883
The non-audit services are conducted in compliance	2.63	.838
Overall		

Source: own survey, 2023

According to our criterion, item two (A different department of the firm provides non-audit services) has a mean value of 3.82 or a response rate of "Agree.". It suggests that companies are connected to the industries through non-financial services they offer, rather than just audit services. The average scores for the following statements are 2.85, 2.88, and 2.63: non-audit services are provided by a different department within the company, appropriate measures are taken to prevent potential conflicts of interest, and non-audit services are carried out by the law.

Every mean value matches a "neutral" response rate according to our criterion. It suggests that businesses are not collaborating effectively with outside auditors to obtain non-financial services necessary for improved financial outcomes.

4.5. Dependent variable (Financial performance)

Table 10 Financial performance

	Mean	Std. Deviation
The organization's profitability is significantly increasing from time to time	3.28	.905
Our company's financial efficiency is improved	2.78	.891
Our firm Repayment capacity is enhanced	2.65	.662
Overall		

4.4. Pearson correlation

In situations where two or more independent variables are present, multiple correlations and the equation characterizing such a relationship are employed. The relationship between independent variables (financial performance) and dependent variables (professional competence and experience, external audit standards, auditor independence, and provision of non-audit services) was calculated in this context using Pearson correlation analysis of thumb.

To decide about the level of strength among dependent and independent variables the following criterion is used.

Table 11 Rule of thumb

Range of coefficient	Description of strength

±0.8 to ±1.00	Very strong
±0.61 to ±0.8	Strong
±0.41 to ±0.60	Moderate
±0.21 to ±0.40	Weak
±0.00 to ±0.20	No relation

Source: (Bhattacharjee, 2012)

4.4.1. Correlation among variables

Table 12 Correlations

	F P P	A I	E A S	P C E	PN A
F P P	Pearson Correlation	1	.77**	.632**	.843**
	Sig. (2-tailed)		.000	.000	.000
	N	40	40	40	40
A I	Pearson Correlation	.838*	1	.682**	.797**
	Sig. (2-tailed)	.000		.014	.000
	N	40	40	40	40

E A S	Pearson	.7	.6	1	.3	.55
	Correlation	77*	82**		85*	5**
	Sig. (2-tailed)	.000	.000		.014	.000
	N	40	40	40	40	40
P C E	Pearson	.6	.3	.3	1	.62
	Correlation	32*	84*	85*		6**
	Sig. (2-tailed)	.000	.014	.014		.000
	N	40	40	40	40	40
P N A	Pearson	.8	.7	.5	.6	1
	Correlation	43*	97*	55**	26**	
	Sig. (2-tailed)	.000	.000	.000	.000	
	N	40	40	40	40	40

**.

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

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

Source: own survey, 2023

All of the audit report's dimensions have a direct, favourable relationship with financial performance, as shown by the correlation matrix above. Furthermore, the correlation coefficients are all rated between 0.632 and 0.843, indicating a "strong" level of strength.

4.5. Explanatory analysis

Various statistical tests for hypothesis testing are the focus of inferential analysis, which assesses whether valid data can be taken into consideration to suggest a conclusion or conclusions. It is also related to population value estimation. The main method used to complete the task of interpretation is inferential analysis. Multiple linear regressions and coefficient analysis were the primary inferential techniques utilized in this study to examine the relationship between the dependent and independent variables.

The researcher verified that all assumptions related to linear regression were met before performing multiple linear regression (see Appendix Two).

4.7.1. Regression analysis

Multiple linear regression analysis is the most common kind of linear regression analysis. Multiple linear regression is used as a predictive analysis in this study to explain the relationship between audit report dimensions and financial performance. Because it enables the researcher to take into account each of these potentially important features in a single model, multiple linear regression is used.

One of the advantages of this approach is a more precise comprehension of the connection between every component and the result. Two sets of data were used in this study to create the multiple regression equation: dependent variables and independent variables. Regression equations are primarily used to help researchers better describe, analyse, predict, and regulate the variables that are being studied.

In the instance of particular manufacturing companies, regress financial performance on independent variables.

$$Y_i = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4$$

Where:

Y is the dependent or predicted variable (financial performance)

a is the y-intercept, i.e., the value of y when all X1, X2, X3 and X4 are 0.

X1 = external audit standards

X2= auditor independence

X3= professional competence and experience

X4= provision of non-audit services

a is the intercept term which gives the mean or average effect on Y if all the variables are excluded from the equation.

$\beta_1, \beta_2, \beta_3,$ and β_4 refer to the coefficient of their respective independent variable, which measures the change in the mean value of Y, per unit change in their respective independent variables.

Table 13 model summary

Model Summary b

Model	R	R Square	Adjusted R Square	Std. error of the Estimate	Durbin - Watson
1	.941 ^a	.885	.871	.24700	1.219

(Constant), PNA, EAS, PCE, AI

a. Predictors:

b. Dependent Variable: FPP

In this study, Adjusted R squared was used to investigate the cause-and-effect relationship between financial performance and audit report dimensions. One version of R-squared that accounts for the number of predictors in the model is called adjusted R-squared. Because of its ability to increase when a new variable improves the model more than would be expected by chance, it is used in this study. A predictor declines if its improvement on the model is less than anticipated. The adjusted R-squared is usually greater than zero. It is consistently less than R-squared. With the aid of ANOVA, the overall model was also found to be significant. The value of adjusted R² = .871 indicates that the entire variation in the dependent variable (financial performance) is explained or caused by 87.1% of the change in all independent variables. The table below displays the results.

Table 14 ANOVA

ANOVA a

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	16.359	4	4.090	67.036	.000 ^b
	Residual	2.135	35	.061		
	Total	18.494	39			

a. Dependent Variable: FPP

b. Predictors: (Constant), PNA, EAS, PCE, AI

With an F-statistic or F-ratio of 67.036 for the overall analysis, the above ANOVA table generally demonstrates a strong relationship between the study's dependent and independent variables. It is also important to note that the F-value is highly significant (as p=. 000~. 01).

Table 15 Regression coefficient/coefficient Matrix

Coefficients a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.748	.238		-3.150	.003
	AI	.335	.124	.306	2.692	.011
	EAS	.351	.086	.329	4.066	.000
	PC E	.219	.081	.210	2.704	.010
	PN A	.382	.157	.284	2.434	.020

a. Dependent Variable: FPP

The table indicates that the coefficients for all independent variables are positive, suggesting that as the independent variable increases, the dependent variable (financial performance) also

increases. Utilizing standardized coefficients from the table, the regression equation of the research model can be expressed as follows:

$$FP = .306*AI + .329*ES + .210*PCE + .284*PNA.$$

Consequently, it can be inferred that each dimension of Audit reports positively and significantly impacts financial performance.

CHAPTER FIVE

MAJOR FINDINGS, CONCLUSIONS, AND RECOMMENDATION

This chapter incorporates a summary of the major findings and the conclusion regarding the major findings of the study based on results found from the data collected in the form of both primary and secondary data. The chapter also contains the recommendations forwarded depending on the arrived conclusion.

5.1 Conclusions

The main objective of this study was to investigate to determine the effectiveness of audit reports on the improvement of financial performance in the case of some selected private companies in Addis Ababa city Administration. Moreover, the study has four specific objectives; To identify the major challenges confronting auditors in giving effective audit reports on the private sector, To examine the extent to which auditors' independence is infringed upon by the intervention of the management, To assess the level of significance of classified information available to the auditors but not disclosed in their financial reports on their sector, To examine the level of significant of the gap between company expectation and content of the audit report.

External auditing is effective from the perspective of carrying out the audit work in compliance with the applicable auditing standards; however, the external auditor does not comply with international auditing standards. From the perspective of auditors' independence, the findings show that the auditor's work is guided by a code of ethics and that the external auditor rotation occurs as required by regulation and standards for better auditing practices to

enhance the financial performance of firms. However, issues like safeguards in place to regulate the interaction between the auditors and management and sufficient size and composition are inadequate and need to be improved.

Professional competence is another important area of investigation for the study; the results suggest that external auditors lack the professional competence necessary to carry out the audit function effectively and that hiring external auditors is not based primarily on professional competence, as is also reported when hiring external auditors by firms based primarily on professional experience.

The value of adjusted $R^2 = .871$ means that the total variation in the dependent variable (financial performance) is explained or caused by 87.1 per cent of the change in all independent variables.

The Pearson correlation result shows that all dimensions of audit reports have a direct and positive relationship with financial performance. Moreover, all the correlation coefficients are rated between 0.632 and 0.843 which implies that the level of strength is “strong”

All independent variable coefficients are positive, implying that as the value of the independent variable rises, the mean of the dependent variable (financial performance) rises as well.

5.2 Recommendation

The study also finds that the provision of non-audit services is positively correlated with financial performance, so firms should pay attention to the professional training of their staff at all levels.

In addition, people should be given more responsibility for their work. Auditor independence is strongly correlated with the financial performance of firms, so companies are advised to give external auditors a competitive advantage by increasing their level of independence by applying acceptable auditing standards to their environment.

Organizations would also be assured of audit quality by creating an environment that promotes auditor independence.

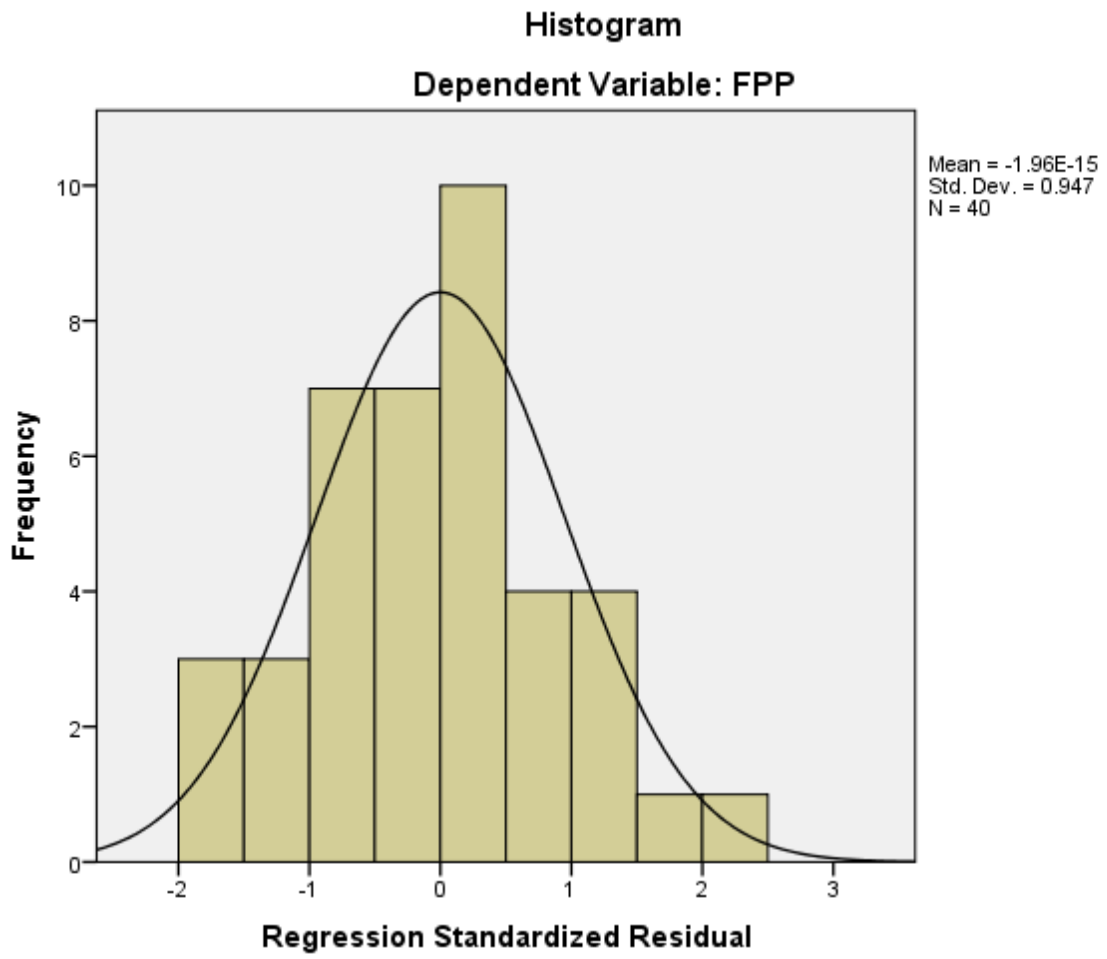
Appendix

Assumption

Coefficients^a

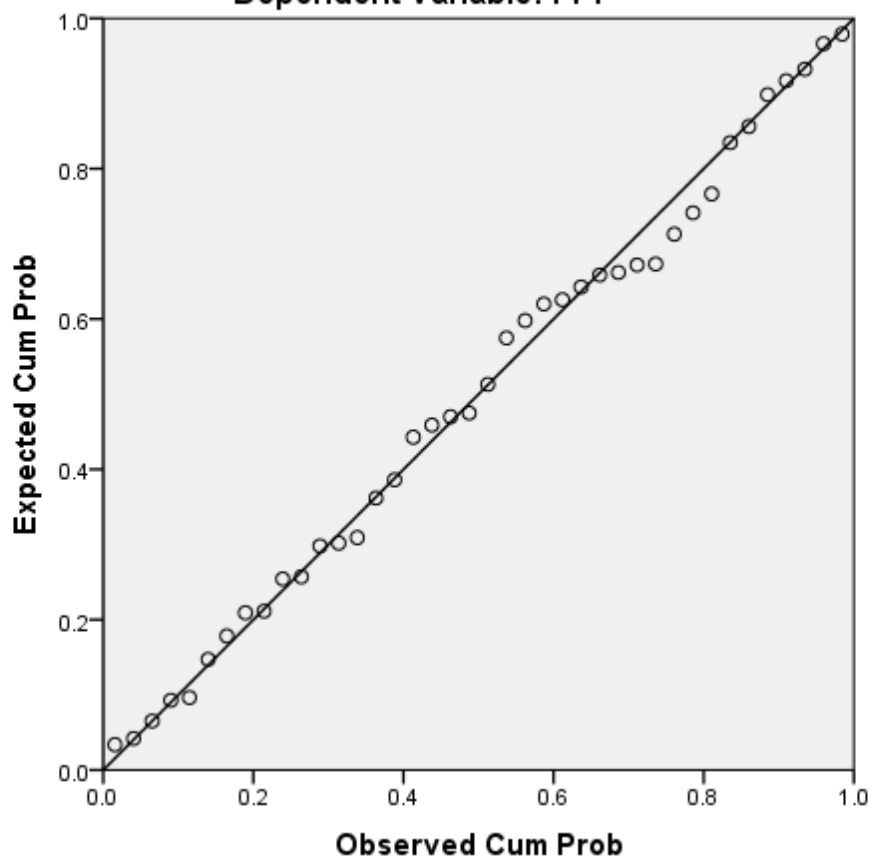
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics		
	B	Std. Error	Beta			Tolerance	VIF	
1	(Constant)	-.748	.238					
	AI	.335	.124	.306	2.692	.011	.255	3.928
	EAS	.351	.086	.329	4.106	.000	.513	1.950
	PCE	.219	.081	.210	2.704	.010	.548	1.824
	PNA	.382	.157	.284	2.434	.020	.242	4.131

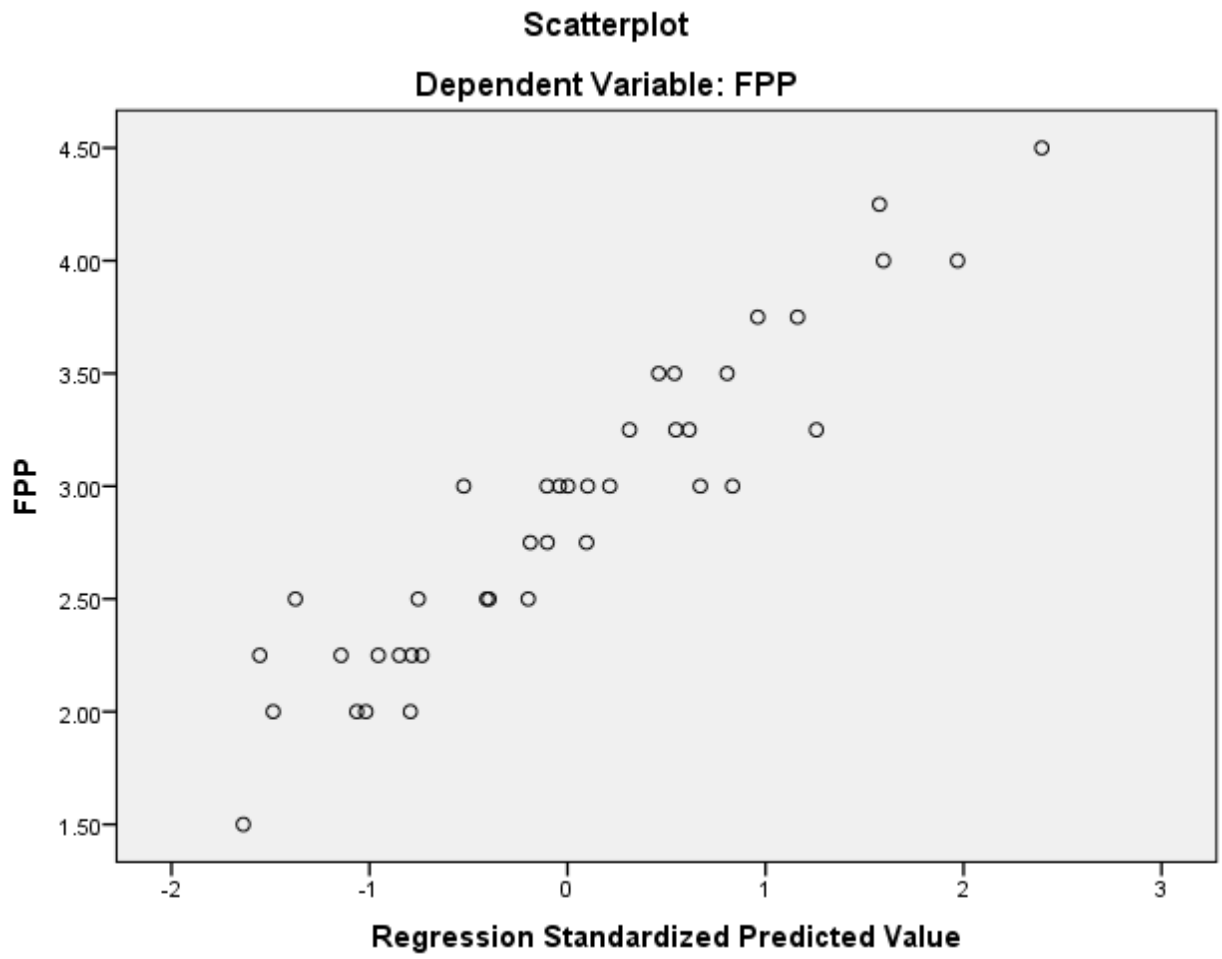
a. Dependent Variable: FPP



Normal P-P Plot of Regression Standardized Residual

Dependent Variable: FPP





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Appendix
Addis Ababa University
College of business & economics
Department of accounting and finance
Questionnaires

Dear respondent,

The purpose of this questionnaire is only to analyse the “Effectiveness of audit report on the improvement of financial performance in case of selected private organizations in Addis Ababa”. The information obtained will be utilized strictly for academic purposes and utmost confidentiality will be exercised. Thank you for your participation in the study.

Thank You in Advance for Your Cooperation

Assefa Belaynew

Direction

- » There is no need to write your name or other identities
- » Your response would be kept confidential and was used only for academic purposes
- » Please respond to the item in the questionnaire by putting a tick mark (√) inside the box.

SECTION A: Background information

Respondents Details:

1. Company Name:

2. Position Held:

3. Gender

Male

Female

4. What is your age?

5. Number of years worked in the Company

SECTION B: External audit standards

Kindly indicate the extent to which the following statements fit with the use of relevant auditing standards by the External Auditor where 1= Strongly Disagree; 2= Disagree; 3= Neither Agree nor Disagree; 4= Agree; 5= Strongly Agree

Statement	Strongly Disagree	Disagree	Neither agree nor disagree	Agree	Strongly Agree
The external auditor complied with international auditing standards					
The effectiveness of the audit resulted from performing the audit work in compliance with the applicable auditing standards					
Compliance with the applicable external auditing standards affect the financial performance of the company					
Complying with auditing standards is a significant contributor to audit quality					

SECTION C: Auditor independence

Kindly indicate the extent to which you agree with the following statements regarding auditor independence where 1= Strongly Disagree; 2= Disagree; 3= Neither Agree nor Disagree; 4= Agree; 5= Strongly Agree

Statement	Strongly Disagree	Disagree	Neither agree nor disagree	Agree	Strongly Agree
There are safeguards in place to regulate the interactions between the auditors and management					
The composition and size of the audit committee is adequate to provide support to the external auditor's work					
The rotation of the senior audit partner complies with the applicable auditing standards					
The auditor's work is guided by a code of ethics					
The external auditor rotation takes place as required by regulation and standards					

SECTION D: Professional competence and experience

Kindly indicate the extent to which you agree with the following statements regarding the external auditor's professional competence where 1= Strongly Disagree; 2= Disagree; 3=Neither Agree not Disagree; 4= Agree; 5= Strongly Agree

Statement	Strongly Disagree	Disagree	Neither agree nor disagree	Agree	Strongly Agree
The external auditors are professionally competent to perform the audit function effectively					
Professional competence is a key consideration when hiring external auditors					
Professional experience is a key consideration when hiring external auditors					
The external auditor detects and report fraud and other financial misappropriations					

SECTION E: PROVISION OF NON-AUDIT SERVICES

Kindly indicate the extent to which you agree with the following statements in regard to the provision of non-audit services by the external auditor where 1= Strongly Disagree; 2= Disagree; 3= Neither Agree not Disagree; 4= Agree; 5= Strongly Agree

Statement	Strongly Disagree	Disagree	Neither agree nor disagree	Agree	Strongly Agree
Beside the audit of financial statements, the external auditors also provide non-audit services to the Company					
A different department of the firm provides non-audit services					
There are proper safeguards in place to check against possible conflict of interest					
The non-audit services are conducted in compliance with applicable standards and regulations					

SECTION F: Financial performance

Kindly indicate the extent to which you agree with the following statements in regard to ~~the~~ provision of non-audit services by the external auditor where 1= Strongly Disagree; 2=Disagree; 3= Neither Agree not Disagree; 4= Agree; 5= Strongly Agree

Statement	Strongly Disagree	Disagree	Neither agree nor disagree	Agree	Strongly Agree
The organization's profitability is significantly increasing from time to time					
Our company's financial efficiency is improved					
Our firm Repayment capacity is enhanced					