

Addis Ababa
University
(Since 1950)



**“Determinants of perceptions of External Auditors”
Independence in Ethiopian private Audit firms”**

By Shumie Waktola Gudich

**Research Project Submitted to the
Department of Accounting and Finance
College of Business and Economics**

**Presented in Partial Fulfillment of the Requirements for the Degree
Master of Science in Accounting and Auditing**

Addis Ababa University

January 2016

DECLARATION

I undersigned, and declare that this project paper is my original work and has not been presented for a degree in any other university, and that all source of material used for the project have been duly acknowledged.

Declared by:

Name: Shumie Waktola

Signature _____

Date _____

Confirmed by Advisor:

Name: Dr Abebaw Kassie

Signature _____

Date _____

Place and date of submission: Addis Ababa, January 2016

ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES

This is to certify that the project paper prepared by Shumie Waktola, entitled “Factors affecting External Auditors Independence in Ethiopian Private Audit Firms” and submitted in partial fulfillment of the requirements for the degree of Master of Science in Accounting and Auditing complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

Internal examiner: Dr. _____ Signature _____ Date _____

External examiner: Dr. _____ Signature _____ Date _____

Chair of Department or Graduate Program Coordinator

ABSTRACT

Auditor independence is fundamental to public confidence in audit reporting and the auditing profession. The users of audit reports must have confidence in the integrity and objectivity of auditors. Without definite auditors' independence audit profession has little value. This study examines factors affecting auditors' independence in Ethiopian private audit firms. Survey research design was employed in carrying out the study. Data were collected using Likert-rated questionnaire; which was administered to 78 auditors in 26 Audit firms in Ethiopia. All audit firms of grade A and B in Ethiopian were covered for the study. Analysis was carried out using descriptive statistics and, regression analysis while hypotheses formulated were tested by fitting the regression equation for significance. The results revealed that level of competition in the audit services market, tenure of an audit firm serving the needs of a given client and size of audit fees received by audit firm in relation to total percentage of audit revenue do have negative and significant effect on auditors independence and the provision of non-audit service has positive significant effect on auditors' independence. Size of audit firms and existence of audit committee do not have significant effect on auditor independence for this study. Client related factors and industry situation do have significant effect on auditor's independence. The main recommendation is that auditors should remain strictly independent in mind and in appearance.

Key words: *Auditors, independence, Ethiopia, audit firm, tenure, Audit market, audit fees, Non audit services and Audit committee*

ACKNOWLEDGEMENT

It gives me a great pleasure to extend my sincere gratitude for those who helped me in making this research project paper. First and foremost I would like to thank the almighty God for having seen me through the course without any "incident" and gave me power and patience in every endeavor of my life.

Next I wish to express my sincere and profound gratitude to my advisor Dr. Abebaw Kassie for his untimely advice and encouragement throughout this research. Thank you for your valuable time and your constructive comments and suggestions.

My thanks also go to my employer, the Oromia Regional State Auditor General, for the sponsorship of this MSc program in Accounting and Auditing. My appreciations also go to my brother Dr. Dereje Waktola and my friend Mr. Dejene Kebede for their comments and assistance with SPSS. I would also like to thank all the lectures who taught me various courses during the MSc program.

This paper would not have been possible without the support of the staffs of Audit firms especially General managers, Audit managers, Senior auditors for their cooperation in providing all the necessary data required for the study and sharing their valuable time. The almighty God may bless all of them.

Finally, I express my thanks to my family members who have been supporting and encouraging me throughout the period of the study as well as my life as a whole especially to Ato Legesse Ayane, W/ro Tenegne Beyecha, W/rt Kebebush Ayane, Ato Kabe kumbi and Ato Tullu Gemechu.

TABLE OF CONTENTS

PAGES

| | |
|---|-------------|
| ABSTRACT | ii |
| ACKNOWLEDGEMENT | iii |
| LIST OF FIGURES | vii |
| LIST OF TABLES | viii |
| LIST OF ACRONYMS AND ABBREVIATIONS | ix |
| CHAPTER ONE | 1 |
| INTRODUCTION | 1 |
| 1.1. Background of the Study | 1 |
| 1.2 Statement of the Problem | 3 |
| 1.3 Objective of the Study..... | 4 |
| 1.3.1 General Objectives | 5 |
| 1.3.2 Specific Objectives | 5 |
| 1.4 Significance of the Study | 5 |
| 1.5 Scope of the study | 6 |
| 1.6. Limitation of the study | 6 |
| 1.7. Organization of the study | 6 |
| CHAPTER TWO | 8 |
| LITERATURE REVIEW | 8 |
| 2.1 The Demands for Auditing | 8 |
| 2.2 Auditor independence | 10 |
| 2.3 Factors affecting Auditors independence | 13 |
| 2.3.1 Size of Audit Firm | 14 |

| | |
|---|-----------|
| 2.3.2 Level of competition in the Audit Service market | 15 |
| 2.3.3 Tenure of an Audit Firm | 16 |
| 2.3.4 Size of Audit Fees | 17 |
| 2.3.5 Provision of Non-Audit Service (NAS) | 17 |
| 2.3.6 Existence of Audit Committees | 18 |
| 2.4 Conceptual Framework | 18 |
| 2.5 Research Hypotheses..... | 19 |
| CHAPTER THREE..... | 21 |
| METHODOLOGY | 21 |
| 3.1 Research design | 21 |
| 3.2 Target Population and study coverage..... | 21 |
| 3.3 Data collection method | 22 |
| 3.4 Validity and reliability assessment | 23 |
| 3.4.1 Validity of the Instrument | 23 |
| 3.4.2 Reliability of the Instrument..... | 23 |
| 3.5 Data Analysis method | 24 |
| 3.5.1 Regression Model..... | 24 |
| 3.6 Ethical issues | 25 |
| CHAPTER FOUR..... | 26 |
| DATA ANALYSIS PRESENTATION, FINDINGS AND DISCUSSION..... | 26 |
| 4.1 Socio-demographic characteristics | 26 |
| 4.2 Descriptive analysis | 27 |
| 4.3 Regression analysis | 29 |
| 4.3.1 Normality test | 29 |
| 4.3.2 Multicollinearity test | 30 |
| 4.3.4 Main findings of the analysis | 33 |

| | |
|--|-----------|
| 4.4 Discussion of Findings | 35 |
| 4.4.1 Size of Audit Firm | 36 |
| 4.4.2 Level of Competition in the Audit Services Market | 37 |
| 4.4.3 <i>Tenure of an Audit Firm Serving the Needs of a Given Client</i> | 37 |
| 4.4.4 Size of Audit Fees Received by Audit Firm | 38 |
| 4.4.5 Provision of Non Audit Services..... | 38 |
| 4.4.6 Existence of Audit committees..... | 40 |
| CHAPTER FIVE:..... | 41 |
| CONCLUSION AND RECOMMENDATION..... | 41 |
| 5.1 Conclusions | 41 |
| 5.2 Recommendation | 42 |
| 5.3 Scope for Further Research..... | 42 |
| 6. Bibliography | 44 |
| APPENDIX (1): Survey Questionnaire for Audit Firms..... | 49 |

LIST OF FIGURES

| | |
|---|----|
| Figure 2.1: conceptual framework of the six Factors affecting Auditor Independence..... | 19 |
| Figure 4.3.1 Normality Q-Q plot for auditor independence..... | 31 |
| Figure 4.3.3.1 Visual test to homogeneity..... | 33 |

LIST OF TABLES

| | |
|--|----|
| Table 3.1 Result of Reliability Analysis for Pilot Test..... | 24 |
| Table 4.1.1 Socio-demographic characteristics of the respondents..... | 26 |
| Table 4.2.1 the means and standard deviation of the variables included in regression..... | 29 |
| Table 4.3.2.1 Variance inflation factors as a measure of Multicollinearity..... | 32 |
| Table 4.3.3.1 Formal test to homogeneity..... | 34 |
| Table 4.3.4.1 Regression coefficients for independent variables identified to affect Auditor independence..... | 34 |
| Table 4.4.1: Summary Result of Hypotheses Testing..... | 36 |

LIST OF ACRONYMS AND ABBREVIATIONS

ACCA- Association of chartered certified accountants

AI- Auditor Independence

APB-Accounting Principles Board

CPA- Certified public accountants

EFAA- European Federation of Accountants and Auditors

FCCA-Fellowship of chartered certified accountants

GAAS -Generally Accepted Auditing Standards

IESBA- International Ethics Standards Board for Accountants

IFAC – International Federation of Accountancy

ISA- International standards for Auditing

MAS- Management Advisory services

NAF-Non audit fees

NAS – Non audit Services

OFAG- Office of the Federal Auditor General

PAI- Perception of Auditor performance

SPSS- Statistical Package for Social Sciences

TVET-Technical, vocational and educational training

VIF- Variance inflection factors

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

The immediate role of audit independence is to serve the audit, it makes the audit more effective by providing assurance that the auditor will plan and execute the audit objectively. The primary purpose of audit independence its objective must be sought in the objective of the audit. The immediate objective of the audit is to improve the reliability of information used for investment and credit decision, independence is essential to that contribution. More broadly, the objective of the audit is to contribute to the effectiveness of the capital markets (Robert et al. 1998).

Improvements in the reliability of corporate disclosure reduce the risk that an investor or creditor will make a poor decision because the information is inaccurate or otherwise inadequate in quality. This information risk is present every time an investor or creditor uses information to assess the economic risk of a potential investment. The better the quality of the information investors and creditors use for their assessments of economic risk, the better their chances of making sound decisions (Robert et al. 1998).

There are other stakeholders, internal as well as external, that also need reliable information about the company. Often the different stakeholders need different information, but they all depend on the quality of the information they receive for which the auditor's role becomes crucial (Deegan et al. 2011). As a result, the stakeholders have to trust that the auditors perform good reviews that help the companies provide accurate figures. Since the auditor reviews the reports on behalf of the stakeholders, it should be done without favor and without bias. The auditor should in other words be independent (Wines, 2011).

Often it is difficult for an auditor to act independently, if a threat to the independence occurs, the auditor must identify that threat and eliminates/ reduces it to an acceptable level before he or she can continue with or accept the assignment. If the auditor cannot reduce the threats using safeguards he or she must resign from the engagement or choose to reject it (Gordon, 2003).

The Commercial Code of Ethiopia contains articles describing the auditing practice in Ethiopia provisions requiring partnership and corporation (Share Company) to keep books and accounts related to corporations specifically about appointment of auditors, competency of auditors, professional secrecy and liabilities of auditors. Furthermore, the code specifies persons who are founders and beneficiaries of a company or its subsidiary, persons related by blood to the fourth degree, or persons who receive remuneration from company founders. It also states that directors are not to engage in auditing that company (principle of independence).

According to the Commercial Code, auditors are liable to client and third party for losses they cause, for issuing inappropriate audit report, for failure to inform the laws for any offences that they knew were committed by the client that affects the public (commercial code 1960). An independent auditor is typically used to avoid conflicts of interest and to ensure the integrity of the auditing process. When an audit is performed, it is the financial auditor's job to make sure that records are examined in an honest and forthright manner.

In Ethiopia there is no quality review of auditors' work, local professional accountancy qualification and strong professional association. Enforcement mechanisms of financial reporting requirements are nonexistent because of lack of capacity in regulatory institutions and the absence of penalties in the regulations (World Bank, 2007). Independent auditors or external auditors /private audit firms/ are certified by Office of the Federal Auditor General (OFAG) - until December 2014. After December 2014, the Ethiopian Accounting and Auditing Board (EAAB) were established to regulate the accounting and Auditing profession in Ethiopia (proclamation No 847/2014).

The importance of the auditor's independence and impartiality has been controversial in recent years when several auditing scandals were revealed. This resulted in stricter guidelines on how the financial statements should be prepared, for example the Sarbanes-Oxley Act which was a result of the Enron's collapse (Healy et al. 2003). The aim of this paper is to explore determinant perception of external auditors' independence in Ethiopian private Audit Firms.

1.2 Statement of the Problem

Auditor independence is questionable upon the failure of audit role in various corporate scandals such as Enron, WorldCom, and Tyco International which gained the attention of the statutory body to enforce the law for improved governance of auditors. It is generally believed that independently audited financial statements result in the generation of true and fair accounting information that will help stakeholders to form rational expectations about firms and minimize the agency cost. It can also be argued that lack of independence would lead auditors to collaborate with the management of Organizations and would produce misleading accounting information (Shafie et al., 2009).

In recent times, media comments on corporate scandals have tended to focus heavily on the issue of auditor independence (Ajagunna, 2012). These financial scandals had a detrimental effect on the public's perception of auditors. More worryingly, the issues related to independence are threatening the survival of audit firms of all sizes and indeed it has the power to destroy the accountancy profession as a whole (Abu-Bakar, & Ahmad, 2009). It is therefore vital that auditors maintain their independence and provide a high quality of auditing. This ensures the credibility of financial information not only for the purpose of reducing the number of corporate scandals but most importantly for the survival of their profession and the development of healthy financial and capital market (Abu-Bakar, 2006). "If an auditor is not independent, one would presume that the auditing is a waste of time and that the figures in the financial statements may be meaningless" (Higson, 2003).

In Ethiopia, the history of auditing goes back to 1930's even if the profession has long life its development is not as expected. Only with a qualified auditors and audit work is the profession's development and the reliability of its audit report can be thinkable. There are many challenges facing auditors in exercising their job. A challenge, in this context, can be something, which defend or tackle auditors from achieving their objectives. Auditing as a profession need auditors to be competent enough in skill and experience, be independent from any conflict of interest, be careful in conducting their work and so on. In the absence of such values, it is difficult for them to provide qualified information (Lukas Beyashe, 2014).

Ethiopia is among developing countries where accounting and auditing profession has not yet developed and is no locally developed auditing standards and nationally promulgated standards to be followed by auditors, but it was widely known that Generally Accepted Auditing Standards (GAAS) or International Standards for Auditing (ISA) have been adopted by practically all auditors in private sector (Muluneh Beyene, 2008)

In addition, if the awareness of the public, audited entities and political person's is not positive, the audit work could not be an easy task as they may harm the independence of the auditor. Auditors should maintain an independent stance and remain impartial not only in facts but also in appearance to provide independent information. Challenges of independence may come from the client or the users of the information. If the auditor is not independent from Client, he/she can face difficulty for him/her to report on Client fault. Independence of an auditor can be hindered due to political, economic or social pressures (Lukas Beyashe, 2014).

In the literature of Ethiopia auditing system, very little is known about auditor independence. Furthermore, no research has been found that identify the determinant of perception of the external auditor independence. Studies done on Auditing by different Ethiopian researchers like Mihret Getaneh (2010) on "Antecedents and Organizational Performance Implication of Internal Audit effectiveness", Fekadu Bethlehem,(2009) on "internal Audit Practices", Muluneh Beyene (2008) on "Auditors Professional Responsibilities and Legal Liability with Regard to Private Auditors in Ethiopia", Adane wuduand (2014) on "Auditor responsibility and fraud detection in Ethiopian private audit firms" and finally research done by Gelaneh Amsalu (2011) on the "Impact of extended Audit tenure on Auditors independence and Audit Quality in Addis Ababa University" but all these did not included determinant perception of external auditors" independence in Ethiopian. Therefore with the problems discussed above and along with the gap in the literature it need to conduct extensive research on determinant perception of external auditor independence in Ethiopian private audit firms in ensuring that the organizations have reliable and creditable financial statements for their stakeholders.

1.3 Objective of the Study

Depending on the problems which is discussed in the above, the study have both general and specific objectives

1.3.1 General Objectives

The main objective of this research is to investigate the determinant perception of external auditors' independence in Ethiopian private audit firms.

1.3.2 Specific Objectives

Specifically, the study has the following specific objectives:

- 1) To investigate whether the size of audit firm affects auditor's independence.
- 2) To examine whether the level of competition in the audit services market affects auditor's independence.
- 3) To investigate whether the tenure of an audit firm serving the needs of a given client affects auditor's independence.
- 4) To examine whether the size of audit fees received by audit firm in relation to total percentage of audit revenue affects auditor's independence.
- 5) To investigate whether the provision of non-audit service affects auditor's independence.
- 6) Examine whether the existence of Audit Committee influence Auditor independence.

1.4 Significance of the Study

The audit of financial statements in the corporate sector by an independent auditor is mandatory by statute, which defines his duties, rights and powers (Salehi, Mansoury & Azary, 2009). It is essential because of the separation of ownership of business from the management in the corporate sector as the former needs somebody who can keep an expert watch on the latter and to whom they can depend for the reliability of accounts as the preparation of financial statement is the prerogative of the management. The auditor has not much to suggest on the form and adequacy of financial statement; but to express an opinion on whether the report prepared by management represents a truth and fair view of the business as at that date.

Independence is fundamental to the reliability of auditors' reports in this regard. If auditors were not independent both in fact and appearance, reports would not be credible, and investors and creditors would have little confidence in them. The results of this research are expected to contribute to the debate on auditor independence by assessing the issue in the context of an emerging market in Ethiopia. This study can also inform government policy makers, Ethiopian

Accounting and Auditing Board, Ethiopian Accounting and auditing Association as to how auditor independence can be structured to assure suitable regulation of the capital market, the findings of the study may help as a basis for further research and discussions, finally the study may also contribute to the sum total of the body of knowledge.

1.5 Scope of the study

This study aims to present factors affecting auditor independence in Ethiopia private audit firms. However, due to time and financial constraint, the study restricts to audit firms of grade A and B in Ethiopia. The researcher believe that the findings of the study will also be applicable to other Ethiopian audit firms, audit firms which operate in the same social, economic, political and legal environment. A well-designed study executed on grade A and B in Ethiopia appears to be representative of the Audit firms" population of our country.

1.6. Limitation of the study

Lack of sufficient previous research studies and accessibility of sufficient current literatures on the subject of auditor independence in the context of Ethiopian is off-putting factor. The dimension of factors affecting auditors independence are very wide in this study only Selected factors affecting auditors independence included in the study, because of manageability, time and financial constraint. The study is considered only from the view point of external auditors, because of time and financial constraints this research could not be seen from others stakeholders viewpoint such as accountants working in the industries, staff members of internal audit, Board members of corporate organizations, managers of corporate organizations and Accounting Scholars who lecture in Universities which is in fact relevant to include this to come up effective results and the researcher believed this will be another research area.

1.7. Organization of the study

This research paper is segmented into five chapters. Chapter one sets out the statement of the problem, objectives of the study, significance of the study, scope and limitation of the study and organization of the paper itself. Chapter two contains a review of literature of most significant and theoretical and empirical studies, conceptual framework of the study and research hypothesis. Chapter three detailed the methodology being applied in the research, which includes

research design, target Population and the Sample Size, data collection methods, Validity and reliability assessment and data analysis. In chapter four data Analysis presentations, result and discussion of findings and the final chapter demonstrate conclusions and recommendation.

CHAPTER TWO

LITERATURE REVIEW

Followed by the introduction of research overview, literature review of the research topic are gathered and discussed in this chapter. The review of relevant theoretical model explained the foundation of research constructs. A brief analysis of factors influencing auditor's independence is provided. Conceptual framework is proposed to indicate a clearer picture on the relationship among the important variables. At the end of the chapter, six hypotheses are developed for which I later discuss the statistical analysis to be employed.

2.1 The Demands for Auditing

Auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria (Arens, Elder, and Beasley, 2012). Auditing should be done by a competent, independent person. Management is responsible for allocating a firm's resources efficiently and effectively as well as operating the Organizations on behalf of the principals (i.e., shareholders). In terms of this responsibility, management has to report and disclose to the principals information about the Organization's conditions, including its past performance, the current condition, and future prospects (Wallin, 1992). All of this information is captured in the financial statements. Therefore, the financial statements will be used by the principals and other related-parties as a basis for evaluating the management's performance and the firm's conditions, and also for making sound decisions regarding investments and lending, among other things. However, information contained in the financial statements may be biased and unreliable for several reasons (Arens, Elder, and Beasley, 2012; Rittenberg, Schwieger, and Johnstone, 2008):

1) *Remoteness of information*: A modern Organization separates between ownership and management. In this situation, most shareholders as well as other users of the Organization's

financial statements, cannot interact directly and get first-hand knowledge about the Organization from the management. They also cannot monitor or control the firm's reporting process. In addition, they face difficulties in directly interviewing management, inspecting the Organization's plants, and reviewing the Organization's accounting records. Such remoteness of information may increase the probability of intentionally or unintentionally misstated financial statements.

2) *Biases and motives of the management*: The management has their own interests in providing information to shareholders and users of financial statements. It also has inside information that they may or may not choose to share. Since information contained in the financial statements is controlled by the management, it is possible that they may try to bias the information in their favor. A conflict of interest and incentive between the management and shareholders and the other users could result in bias in the financial statements.

3) *Voluminous data*: As Organizations grow larger the volume of their transactions also increases. This increases the probability that transactions will be recorded improperly and included in the records either intentionally or unintentionally.

4) *Complex exchange transactions*: Over the past few decades, transactions between Organizations have become more complex. Consequently, it becomes more difficult to record these transactions properly. For these reasons, the principals and users of financial statements need assurance regarding the reliability and credibility of financial statements.

They need an independent agent that they can rely on for this information, and an auditor plays the role of such an agent. In addition, in an era in which the capital market plays an important part in the economy, auditors provide two critical roles to capital market participants (Mansi, Maxwell, and Miller, 2004): *an information role and an insurance role*. As an information role, auditors provide independent verification of the information contained in the financial statements. By doing so, auditors increase the reliability and credibility of the financial statements. For the insurance role, auditors, either jointly or separately from management, provide capital market participants with indemnity insurance that covers potential losses. This is because, in many countries, a Corporate Act gives the public the right to sue auditors in case of flawed financial statements.

2.2 Auditor independence

An independent auditor is typically used to avoid conflicts of interest and to ensure the integrity of the auditing process. Independence is freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired or could be impaired. Independence is related to and underpins objectivity. However, whereas objectivity is a personal behavioral characteristic concerning the auditor's state of mind, independence relates to the circumstances surrounding the audit, including the financial, employment, business and personal relationships between the auditor and the audited entity and its connected parties (APB Ethical Standard, 2011).

The AICPA *Code of Professional Conduct* and the IESBA *Code of Ethics for Professional Conduct* both define independence as consisting of two components: independence of mind and independence in appearance. Independence of mind reflects the auditor's state of mind that permits the audit to be performed with an unbiased attitude. Independence of mind reflects a long-standing requirement that members be independent in fact. Independence in appearance is the result of others' interpretations of this independence. If auditors are independent in fact but users believe them to be advocates for the client, most of the value of the audit function is lost (AICPA, 2015, IFAC, 2010).

Auditor independence has been traditionally viewed as the cornerstone of the auditing profession as it being one of the fundamental principles underlying the auditors' work (Firth 1980). To be seen or perceived to be independent is called the unique quality of the auditor that distinguishes it from other professions and professional activities, recognize this when they consider independence to be the essence of auditing that forms the basis for the professional concept of due care, the requirement of service before personal interest and the standard of professional efficiency (Mautz & Sharaf 1961).

In turn, the unique quality of the audit provides the basis on which public determine the auditors' responsibility to society. It is also regarded as an important prerequisite of a well-functioning capital market and critical in protecting the interests of both creditors and shareholders (Moore et al. 2006).

Auditor independence has been analyzed based on two dimensions, which is fact and appearance. “Independence in fact refers to the actual objective state of the relationship between auditing firms and their clients. Independence in appearance refers to the subjective state of that relationship as perceived by clients and third parties”. The preponderance of auditor independence both in fact and appearance is generally approved in theory and practice (Alleyne et al., 2006).

Goldman and Barlev (1974) states that conflicts arise between: Auditors and audited client, Owners and managers, and Auditors own economic motives and audit criteria. Therefore, auditor independence may be compromised when conflicting interests arise as to what is the audit’s role (Alleyne et al., 2006).

Needlessly to say, independence is the corner stone of the accounting profession. As Moore et al. (2006) describe, independence is the only justification for the existence of accounting firms that provides audit service; if it were not for the claim of independence and there would be no reason for external auditors to exist, since their function would be redundant with that of a firm's inside auditors. So far, no formal „theory“ of auditor independence exists and thus, until recently, analytical models concerning independence have been very limited.

DeAngelo, (1981p.186) defined auditor independence as „the conditional probability of reporting a discovered breach“. Because independent behavior (or independence in fact) is generally unobservable, the appearance of independence assumes prime importance among stake holders. This suggests that auditor independence is synonymous with auditor objectivity and the ability to withstand client pressure to acquiesce to substandard reporting.

As already mentioned, it is difficult to directly measure auditor independence, but one can construct proxy for it based on the responses to variables describing auditor independence behavior. To this end, I make use of the Likert scale variables describing the auditor’s opinion of serving as a public (stakeholders) watchdog, exercising their independence as an auditors in their audit firms during the audit duties, supporting auditors independence when undertaking audit duties, and performing reliable audit reports for the financial statements users.

Several factors have been identified in literature which may influence auditor's independence as lack of strict regulations, the nature of the auditor-client relationships, extended audit tenure, provision of Non Audit Services (NAS), and competitive pressures leading to lowballing /price cutting. Accounting scandals of Enron and other giant companies in the west inspire regulators and researchers to scrutinize the auditing profession. Economic dependence (proportion of NAS to total audit fees) of external auditors has received researchers attention. It is argued that provision of NAS by incumbent auditors impair auditor independence.

First, NAS fees make auditors to be financially dependent on their client, and as a result weaken to resist management pressure for fear of losing their business. Secondly, the consultancy nature of NAS puts auditors in a compromising position which potentially threaten their independence about the transaction they audit. In addition, Positive abnormal audit fees or the presence of positive client specific quasi rent creates an incentive for the auditor to compromise independence with respect to a specific client (DeAngelo 1981; DeFond et al. 2002)

However, a counter theoretical argument also suggests that auditors have market-based institutional incentives to act independently. The expected costs of sacrificed independence include the reputation loss and litigation costs associated with audit failures Defond (2002). The size of the audit firm is often considered when examining the issue of fee dependence. For example, DeAngelo's (1981) economic model states that incentives for an auditor to compromise independence will be a balance between the importance of the client and the litigation and reputation costs which could result from breached auditor independence. She further argues that smaller audit firms may have bigger incentives to compromise independence than larger accounting firms as smaller firms have fewer clients and so each client represents a larger proportion of income to the auditor.

Apart from level of NAS and audit fees, auditor size has been the most commonly used quality surrogate and it has been employed in a vast body of prior audit research. DeAngelo (1981) analytically shows that auditor likelihood of reporting breaches (i.e. independence) increases with audit firm size. Thus, according to the DeAngelo's framework, audit quality is a function of the (market-assessed) competence and independence of the auditor. She proposes that the auditor's investments (start-up costs) in the client relationships enable the incumbent auditor to

earn client-specific quasi-rents and that these quasi-rents represent the collateral that is lost if „promises“ are not kept (i.e. in case of audit failure). According to this framework, auditors with a larger number of clients possess greater total collateral and as a consequence of avoiding audit failure arguably report a more independent opinion on client’s accounts (DeAngelo 1981).

2.3 Factors affecting Auditors independence

Auditors act on behalf of funders, taxpayers or shareholders, to provide assurance on the reliability of financial statements. Therefore, investors view audited reports as reliable information that contributes in their investment decisions in companies incorporated by registration. Furthermore, independence of mind and independence in appearance should be maintained by auditor as the two forms of independence will affect the degree of credibility of financial statements (Alleyne et al., 2006).

The majority of empirical studies on the perception of auditors’ independence focused upon finding the significance of the factors which affect auditors’ independence, and in looking whether these factors are positively or otherwise related with perception of auditors’ independence. The auditor is required to be independent and also be seen to be independent by stakeholders of the entity he is reporting on.

Threat according to Chambers Dictionary (2002) implies a source of danger. It may be perceived that threat to independence connotes circumstances that can jettison the “biasedness” of the auditor. The Source of Potential threats to auditor independence have been broadly categorized as one or a combination of the following:

1) *Self-interest threats*: may occur as a result of the financial or other interests of a professional accountant or of an immediate or close family member. 2) *Self-review*: may occur when a previous judgment needs to be reevaluated by the professional accountant responsible for that judgment. 3) *Advocacy threats*: may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised. 4) *Familiarity (or trust) threats*: which may occur when, because of a close relationship, a professional accountant becomes too sympathetic to the interests of others and 5) *Intimidation threat*: which may occur

when a professional auditors may be deterred from acting objectively by threats, actual or perceived (IFAC, 2005, Hayes et al., 2005).

The factors that are likely to give rise to these threats include among the factors that affect perception of auditors independence that have been studied are (a) ability of managers to influence the compensation of auditors, (b) the audit-firm size, (c) the provision of management advisory services (MAS) by the audit firm, (d) the client's financial condition, (e) the nature of conflict issue, (f) the audit firm's tenure, (g) the degree of competition in the audit services industry, (h) the size of the audit fees or relative client size, and (j) the existence of audit committee, (j) the effects of gifts (k) the purchase discount arrangement, (Yost, 1995; Pany & Reckers, 1980; Gul & Tsui, 1992; Shockley, 1981; Gul, 1989; Knapp, 1985; Bartlett, 1993 and Teoh & Lim, 1996).

Even though, the aforementioned, empirical reviews try to point to out their finding as per their study area , it doesn't necessarily mean that the finding of their country necessarily applies for another country, this is because each nations have their own culture, economic background, political environment and other considerations that needs to be taken in to account. When we see the studies conducted in Ethiopia, some research tries to see from the perspective of auditors' legal and professional liabilities, Auditor responsibility and fraud detection, the impact of extended Audit tenure on Auditors independence and Audit Quality perspective, Muluneh Beyene (2008), Gelaneh, Amsalu (2011) and Adane wudu (2014). With that, the present study takes an attempt to examine factors affecting external auditors' independence in Ethiopian private audit firms.

Below I present the review of literature on determinant perception of external auditors' independence in Ethiopian private audit firm.

2.3.1 Size of Audit Firm

Larger audit firms are often considered to be more able to resist pressures from management (i.e. higher auditor's independence). This is proven by almost all the empirical studies that attempted to find the relationship between audit firm size and Auditor Independence, whereby they found

that there is a positive relationship between them (DeAngelo, 1981b; Shockley & Holt, 1983; Gul, 1989; Alleyne et al., 2006; Abu Bakar et al., 2005).

In fact, it has been argued that certain characteristics inherent in small audit practices may increase the danger of impairment of independence, for example, the tendency toward a more personalized mode of service and close relationship with the client (Shockley, 1981). However, as pointed out by Goldman et al., (1974), one should not conclude that large CPA firms are protected to pressures from their clients. Audit Firm Size Measured by Audit Firm Revenues, Number of Offices, and Professional Headcounts on Audit Quality and Audit Fees (Gil et al., 2013).

The study used size of audit firms grade given by OFAG to classify audit firms size in to grade A, B and C. The grading system of audit firms given by OFAG was depends on setting evaluation criteria of their *Staff profile (60%)* and *Office profile (40%)*. Staff profile evaluation criteria including: education level of auditors, numbers of professional of audit firms, salary scale, experience of auditors, human resource development and others benefits of auditors. Office profile evaluation criteria including: net assets of audit firms, professional insurance for auditors, Organization of Office and condition, Office furniture, numbers of client customer, size of recurrent expenditure, recording and profile condition, regional offices, audit manual and others. Audit firms got total point evaluation criteria 75% and above grade A, 50% to 75% Grade B and below 50% grade C (<http://www.ofag.gov.et>).

2.3.2 Level of competition in the Audit Service market

Audit market competition refers as the level of competition within the external audit market (Abu-Bakar et al., 2009). Competition has been identified as the most important environmental change or external factor affecting auditor independence (Shockley, 1981).

Firms operating in an intensely competitive environment may have difficulty remaining independent since the client can easily obtain the services of another auditor. High levels of market competition are generally argued to increase the auditor's economic dependence, reflected in the budget pressures faced by auditors, tender threats by auditees and competitive pricing by auditors. Auditors may have their independence tested when a client engaged in

„opinion shopping”- that is when a client seeks the views of other auditors who will agree with the client’s desired accounting treatment. This client may attempt to force the auditor to go along with the desired accounting treatment by threatening to change auditors (Messier & Boh, 2002, Abu Bakar et al., 2005) study has shown that a higher level of competition may impair the perception of auditor independence.

A number of empirical studies have proven that the high level of competition in the audit firm has resulted in less auditor independence (Alleyne et al., 2006; Abu-Bakar & Ahmad, 2009). Krishnan et al., (2005) however, found the opposite. In explaining this, they argued that the existence of competition caused auditors to be more independent and create a favorable image in order to maintain their clientele.

2.3.3 Tenure of an Audit Firm

Audit tenure is the number of consecutive years or duration of time that the audit firm (auditors) has audited the client, has been mentioned as having an influence on the risk of losing an auditor’s independence. Most writers who discuss the relationship between tenure and Auditor independence support this view (e.g. Alleyne et al., 2006; Abu Bakar et al., 2005). A long association between a corporation and audit firms may lead to such close identification of the accounting firm with the interests of its client’s management that truly independent action by the audit firms becomes difficult. Mautz & Sharaf (1961) pointed out that complacency, lack of innovation, less rigorous audit procedures and a learned confidence in the client may arise after a long association.

Rotation ensures that the auditor remains independent since tenure will be limited and any vested interest will no longer be relevant (Teoh & Lim, 1996). Nevertheless, this suggestion has been opposed (e.g. Shockley 1981; DeAngelo 1981a). The length of audit tenure and the possible effect of switching on auditor independence are still unclear and not explicitly addresses in any of the relevant documents (Abdul Nasser et al., 2006). In studies conducted by Shockley (1981) and Teoh & Lim (1996) however, tenure was not found to have a significant impact on perceptions of independence. Evidence was not found in case of Ethiopian in regulating long audit tenure.

2.3.4 Size of Audit Fees

Audit fees are defined as the amount paid by firms to their auditors to certify the firm's consolidated accounts (Andre, et al., 2011). Therefore, clients can exercise pressure on auditors' judgments and thus affect the auditor independence. Large size of audit fees is normally associated with a higher risk of losing the auditor's independence. The IFAC's Code of Ethics for Professional Accountants (2007) suggests that client size (measured from size of fees) could raise doubts as to independence. In a similar development, the EFAA (October, 1998, p.4) clearly states that, „the (total) fee from one client should not exceed a certain percentage of the total turnover of the audit firm“.

Most empirical studies conducted on size of audit fees do not look at that factor as such; instead they inter-relate it with other factors. For example, Shockley (1982) suggests that the adverse effects of MAS, the size of the audit firm and competition on a third party's PAI actually arise because of the linkage of these variables to audit fees. Nevertheless, there is a study that proves otherwise.

Another study related to the size of audit fees was by Pany & Reckers (1983). They noted that the large size of the client's audit fee (measured as a percentage of office revenues to the audit firm), though do not show any significant impacts on PAI, and have influenced respondents to feel less confidence in the auditor's independence.

2.3.5 Provision of Non-Audit Service (NAS)

Non-audit services (NAS) may be any services other than audit provided to an audit client by an incumbent auditor. Such services may be referred to in the professional and academic press as management advisory services or consulting, but NAS also includes compliance related services (such as taxation and accounting advice) and assurance related services (such as due diligence and internal audit). Compliance related services are closely linked to the annual financial reporting round (Beattie, Brandt and Fearnley, 1996)

Early research related to financial statement users indicated that auditor independence is negatively affected when non-audit services are performed for audit clients (Abu-Bakar et al., 2005; Alleyne et al., 2006; Krishnan et al., 2005). They believe that these collateral services

create a working relationship between the auditor and the client that is too close and that the provision of management advisory services negatively affected auditor's independence.

Contrary to the above, some other studies found a positive relationship between management advisory services provision and auditor's independence. They believe that management advisory services provision enhances the auditor's knowledge of the client, thus increasing the auditor's objectivity (Goldwasser, 1999; Ashbaugh, LaFond, & Mayhew, 2003).

2.3.6 Existence of Audit Committees

An audit committee is a selected number of members of a company's board of directors whose responsibilities include helping the auditors remain independent of management (Arens et al., 2012). For that reason there is much support to suggest a positive relationship between audit committees and auditor independence, which means that the existence of an audit committee will enhance auditor's independence. Teoh & Lim (1996) in their study find that the formation of audit committees has a strong positive impact on enhancing auditor independence.

Similarly, Paten & Nuckols (1970), Knapp (1985) and Lau & Ng (1994) find that the existence of an audit committee increases the likelihood of bankers' approving a loan, which is a reflection of an increased confidence in the auditor. On the contrary, Gul (1989) finds that audit committees did not significantly affect the perceptions of auditor independence.

2.4 Conceptual Framework

The conceptual framework link the independents variables which as factors affecting independents of auditors to dependent variables (independents of auditors in the firms). The relationship between the six factors and auditors independence can be illustrated using Figure 2.1. (Chia-Ah, E., & Karlsson, J., 2010)

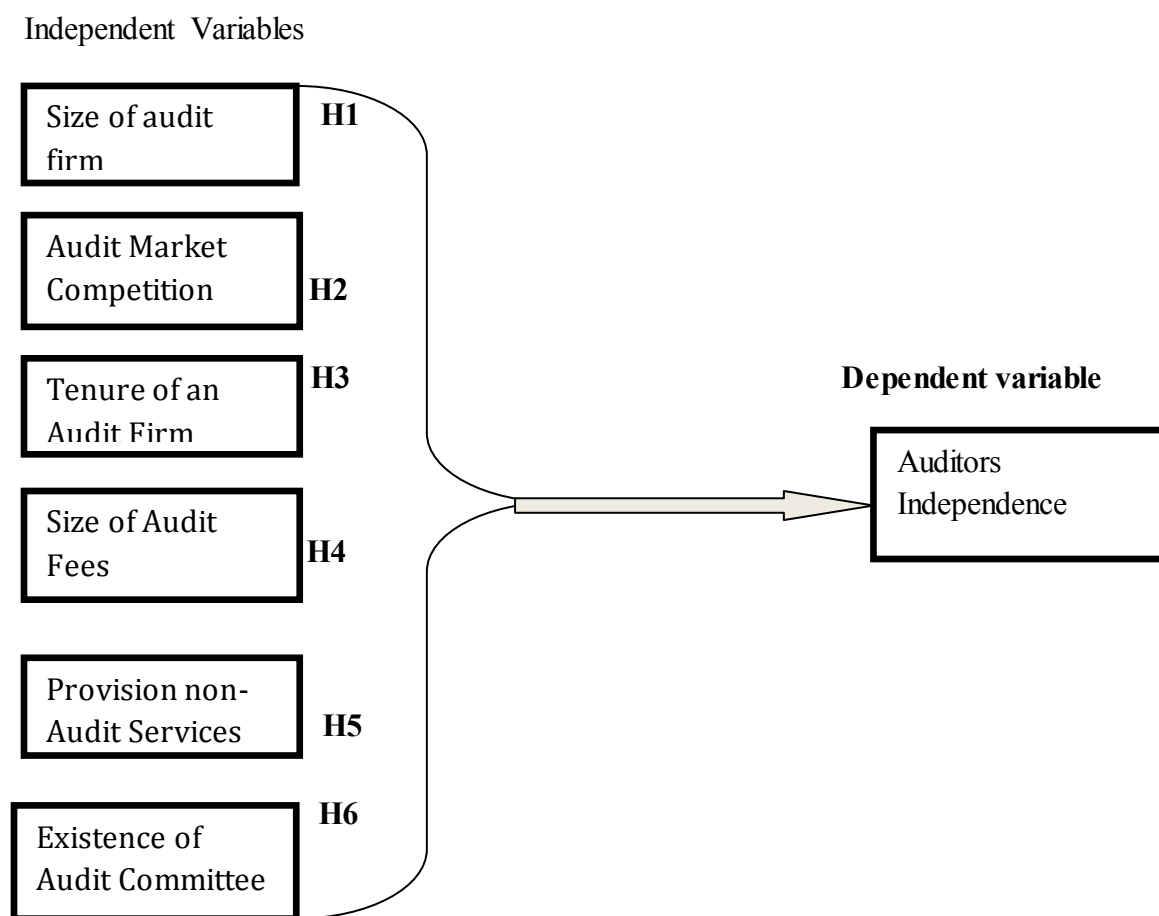


Figure 2.1: conceptual framework of the Factors affecting Auditor Independence

2.5 Research Hypotheses

More formally, the hypotheses depicted in Figure 2.1 may be formulated as follows:

1. H1: Size of audit firm has no significant effect on auditor's independence.
2. H2: The Level of competition in the Audit Service market has no significant effect on auditor's independence.
3. H3: The tenure of an audit firm serving the needs of a given client has no significant effect on auditor's independence.
4. H4: The size of audit fees received by audit firm in relation to total percentage of audit revenue has no significant effect on auditor's independence.
5. H5: The provision of non-audit service has no significant effect on auditor's independence.

6. H6: The existence of audit committee has no significant effect on auditor's independence

Below, the next chapter discussed the research methodology for testing statistical significance of these hypotheses against the null of no relationship between the identified factors and auditor's independence.

CHAPTER THREE

METHODOLOGY

This section discusses the research methodology to be adopted in the study. In particular, the chapter discusses the research design, the target population and study coverage of study, data collection instrument, Validity and reliability assessment, data analysis and ethical issues.

3.1 Research design

The strategy design to collect information is cross-sectional causal research. This design has several advantages: a) it uses multi-data collecting techniques like interviews, observation and questionnaires, b) it provides a rich data that give direction for further research, and c) in contrast with longitudinal research, it is cheap and a lot of information is collected over a short time frame which minimize drop-out rate of participants. More importantly, simple statistical methods can be applied to analyze the data collected using this cross-sectional causal research design. It is also causal research in a sense that it addresses influencing the independence of external auditors in Ethiopian private audit firms

3.2 Target Population and study coverage

Altman and Bland, (1999) defines the population of a research as “all conceivable elements, subjects or observations relating to a particular phenomenon of interest to the researcher”. A research population according to Blanche et al. (2006) relate to the total universe of units from which the sample is to be selected.

Bless and Higson-Smith (2000) defines a sample as “a sub-set of a population which must have properties which make it representative of the whole”. Often in practice, instead of investigating all the elements of the population, collecting information from representative sample of the population is feasible.

In this study the population element are all audit firma in Ethiopia. In view of this there are 89 audit firms of grade A, B and C in Ethiopia, of which grade A are 11 audit firms, grade B are 15 audit firms, and grade C are 63 audit firms (<http://www.ofag.gov.et>).

In current study I purposively decided to survey all grade A and B audit firms in Ethiopia, hence there is no sample selection in this study. The total coverage of audit firms is 26 audit firms. The reasons for study only grade A and B audit firms were their human capital (human resource development and professionals' experience of the auditors), grade A and B account for 50% and above in the grading system evaluation criteria set by OFAG for audit firms, time and resource constraints.

From each grade A and B audit firms' three respondents were considered for questionnaire administration, these include General Manager, Audit manager and senior auditor; they were considered because of their competency, skills and experience in the audit profession. Accordingly a total of 78 questionnaires were administered.

3.3 Data collection method

In this study both the primary and secondary data are employed. The primary data was collected by use of questionnaires which were administered by the researcher. The questionnaires were preferred as a data collection instrument because of its ability to yield the most satisfactory range of reliable data (Blanche *et al.*, 2006). The advantage of selecting this instrument is confidentiality and keeps track of those who do not return the questionnaire on time and need to be reminded again. Questionnaires are also easier to administer thereby making it possible to reach a large population.

Most questionnaires do not require the identity of respondents thereby encouraging honest opinions from them. A researcher will be able to design questionnaires in a way that simplified analysis. Questionnaires format used including the Likert scale closed ended format. The questionnaires are adapted from Abu Bakar *et al.* (2005), Ko Sie Jian, *et al.*, (2012), with some modification particularly on its sequence. The research questionnaire was divided into two sections. Section A provides demographic information of the respondents whereas section B contains information on the respondents' responses to the various variables describing auditor's independence, as well as on the various independent variables that I expect to influence the dependent variable (i.e., the auditor's independence).

3.4 Validity and reliability assessment

In situation where the variable of interest is directly immeasurable, certain questionnaires (also called items) may be used to construct measurement (or proxy) for this variable. In doing so, the validity and reliability questions often arise. As discussed below, the former focus on whether the items measure what it intends to measure and the latter assesses whether the measurement used is consistent.

3.4.1 Validity of the Instrument

Validity refers to the extent to which a method of data collection presents what it is supposed to do (Altman. and Bland, 1999). To establish the validity of instruments, the researcher worked together with the advisor to ensure that the questions are properly framed and they can provide the required data for the study.

3.4.2 Reliability of the Instrument

The reliability of the instrument to be used in this study was tested through a pilot study that was conducted using a sample of 10 respondents from the audit firms. This was in accordance to Mugenda and Mugenda (1999) who suggested that for a pilot study a sample of between 1-10% is appropriate. The reliability was measured using Cronbach's alpha by the help of the statistical package for social sciences (SPSS). Struwig and Stead (2001) describe Cronbach's alpha as a measurement of how well a set of items measure a single one-dimensional talent construct.

The purpose of the pre-test is to verify the logical consistencies, detect problems with a questionnaire, and estimate the reliability of the questionnaires. Alpha was developed by Lee Cronbach in 1951 to provide a measure of the internal consistency of a test or scale; it is expressed as a number between 0 and 1. Internal consistency describes the extent to which all the items in a test measure the same concept or construct and hence it is connected to the inter-relatedness of the items within the test. Internal consistency should be determined before a test can be employed for research or examination purposes to ensure validity. Under the rule, Cronbach's alpha below 0.6 is considered have a poor association whilst Cronbach's alpha higher than 0.7 indicates a good reliability (Cronbach, 1951).

Table 3.1: Result of Reliability Analysis for Pilot Test

| Cronbach's Alpha | Strength of association | Number of items used |
|------------------|-------------------------|----------------------|
| 0.88 | Very Good | 39 |

Source: Developed for the research

The overall Cronbach alpha of this pilot study was shown 0.88 based on the results of the pilot study, this result is Very Good because Cronbach's alpha coefficient for the overall assessment is greater than 0.70

3.5 Data Analysis method

The data analysis is performed in two steps. First, I look at the results of the descriptive statistics, which can be the frequencies (or proportions) for nominal scale variables, the means and variances for Likert scale variables. Based on these results I provide the general overview of the variables involved in the study.

3.5.1 Regression Model

In this regression analysis, auditor independence as the dependent variable and the variables such as audit firm size, auditor market competition, tenure of audit firms serving the needs of a given client, audit fees size, provision of Non Audit services, and the existence of audit committee as independent variables. More specifically, the hypotheses indicated with Figure 2.1 may be tested by fitting the regression equation (Robert N., 2014):

$$\begin{aligned}
 \text{Auditor indep} = & \alpha + \beta_1 \text{AuditFirm} + \beta_2 \text{AuditMarket} + \beta_3 \text{TenurAudit} + \\
 & \beta_4 \text{AuditFee} + \beta_5 \text{NAS} + \beta_6 \text{AuditCommittee}
 \end{aligned}$$

Where *Auditor indep* = "auditors independence", *AuditFirm* - "Audit firm size", *AuditMarket* = "Auditor market competition", *TenurAudit* = "tenure of audit firms serving the needs of a given client", *AuditFee* = " size of audit fee", *NAS* = "provision of Non-Audit services", *AuditCommittee* = "existence of audit committee", α (alpha) is the constant term, and the β 's (beta) are the slope coefficients indicating the effect a particular independent variable after

controlling for the others. Note that the proxy for both the dependent and independent variables are constructed based on the responses provided to the set of questionnaires, as indicated in the appendix.

Such a regression model is often used when assessing the effects of multiple independent variables on continuous (or Likert scale) dependent variable. This regression model is implemented in many statistical programs including SPSS version 20 that I used in the current analysis. However, in order to appropriately interpret and draw valid conclusions from the parameter estimates this model, several assumptions of the model need to be satisfied. These include the *normality of the firms taken*, the linearity of the relationship between the dependent and independent variables, the *multicollinearity* among the independent variables, and the *homogeneity* assumptions. I assess these assumptions of normality, multicollinearity, and homogeneity of using visual plots and statistically principled tests.

3.6 Ethical issues

The major ethical issue in this study ensured the confidentiality of information collected from the respondents. The researcher took time to explain the purpose and objectives of the study to the respondents in advance in order to avoid any misconceptions that could arise due to the nature of questions being asked. The informed consent of all participants in the study was duly obtained and participation was voluntary.

CHAPTER FOUR

DATA ANALYSIS PRESENTATION, FINDINGS AND DISCUSSION

The analysis is based on the data 78 questionnaires distributed and collected 69 questionnaires from respondents of firms auditors in Ethiopia. The socio-demographic composition of the respondents, followed by the descriptive and regression analysis and discussions were shown below.

4.1 Socio-demographic characteristics

The Socio-demographic characteristics of respondent auditors are shown below in table 4.1.1

Table 4.1.1 Socio-demographic characteristics of the respondents

| Socio-demographic categories | In percent | |
|--|---------------------|-----|
| Gender distribution of the Respondents | Male | 84 |
| | Female | 16 |
| Age distribution of the Respondents | 20-30 years old | 21% |
| | 31-40 years old | 39% |
| | Above 40 years old | 30% |
| Professionals Auditors years of experience | Below 5 years | 10% |
| | Between 5-10 years | 35% |
| | Between 11-20 years | 29% |
| | Above 20 years | 26% |
| Auditors educational levels | TEVT/Diploma | 2% |
| | Bachelor's degree | 42% |
| | Master's degree | 17% |
| | FCCA, ACCA, CPA | 39% |
| Current job of respondent | General Managers | 33% |
| | Audit Managers | 29% |
| | Senior Auditors | 38% |

Table 4.1.1 present the composition of the auditors as described in terms of the demographic characteristic variables such as gender, age, years of service, level of education, and current job position. As we can see from the table 4.1.1 majority of the auditors (84%) were men, indicating the male auditor professions domination in Ethiopia.

The age distribution of respondent auditors shows that a majority (39%) of the auditors were in age group of 31-40 years, 30% in the age group above 40 years, and 21% in age group of 20- 30 years. The service years of these auditors range from less than 5 years (10%), 5 to 10 years (35%), 11 to 20 years (29%), and 21 or more years (26%). Can be also seen from the table 4.1.1 that the majority of the auditors who participated in the study (42%) were holders of Bachelor's degree in business related filed, followed by (39%) who had FCCA/ACCA/CPA qualifications, followed by (17%) who had a master's degree in Accounting and Finance, Business administration and only (2%) had TEVT/Diploma in business related field. This implies that majority of the respondents had Bachelor's degree and FCCA/ACCA/ CPA professional qualifications. This level of education was the requirement for the auditors to work effectively without interference that is they could work independently the audit profession. Finally the current positions of respondent auditors are senior auditors 38%, General managers 33% and Audit managers 29% these indicate that the respondent adequate skill, competence and experience in the audit profession.

4.2 Descriptive analysis

Table 4.2.1 provides the means and standard deviations for the following dependent and independent variables: Auditor independence, Audit firm size, Audit market competition, Tuner of audit, Size of audit fee, Non Audit Services, and Existence of audit committee. The values of these variables are obtained by averaging individual over 5 points Likert questionnaires. As we can see from the table below

Table 4.2.1. The means and standard deviation of the variables included in regression

| | Mean | Std. Deviation |
|----------------------|--------|----------------|
| Auditor independence | 3.2705 | .38145 |
| Audit Firm | 3.0266 | .36562 |
| Audit Market | 3.3420 | .44735 |
| Tenure Audit | 2.8430 | .33685 |
| Audit Fee | 3.0261 | .29687 |
| NAS | 3.1425 | .39531 |
| Audit Committee | 2.8986 | .26485 |

Source: survey results

As can be seen from the above table 4.2.1, the mean scores are greater than 3 which was 3.27 for the dependent variable auditor independence, this show that the average auditors provide agree or strongly agree response to the questionnaires of this variable, the standard deviations for auditor independence variable was 0.38 this indicate that variations among the auditors response to these 5 points Likert items.

The mean score for independent variables audit firm size, audit market competition, size of audit fee, and NAS were 3.03, 3.34, 3.03, and 3.14 respectively, these implies that average auditors provide agree or strongly agree response to the items on these independent variables. The standard deviations for audit firm size, audit services market, size of audit fee, and NAS variables were 0.37, 0.45, 0.30 and 0.40 respectively this indicate that variations among the auditors response to these 5 points Likert items.

For the variables tuner audit and audit committee, the average mean scores are slightly less than 3 these were 2.84 and 2.90, implying that average auditors respond disagree or strongly disagree on these items. The standard deviations of tuner audit and audit committee show 0.34 and 0.27 these indicate variations among the auditors response to these 5 points Likert items.

4.3 Regression analysis

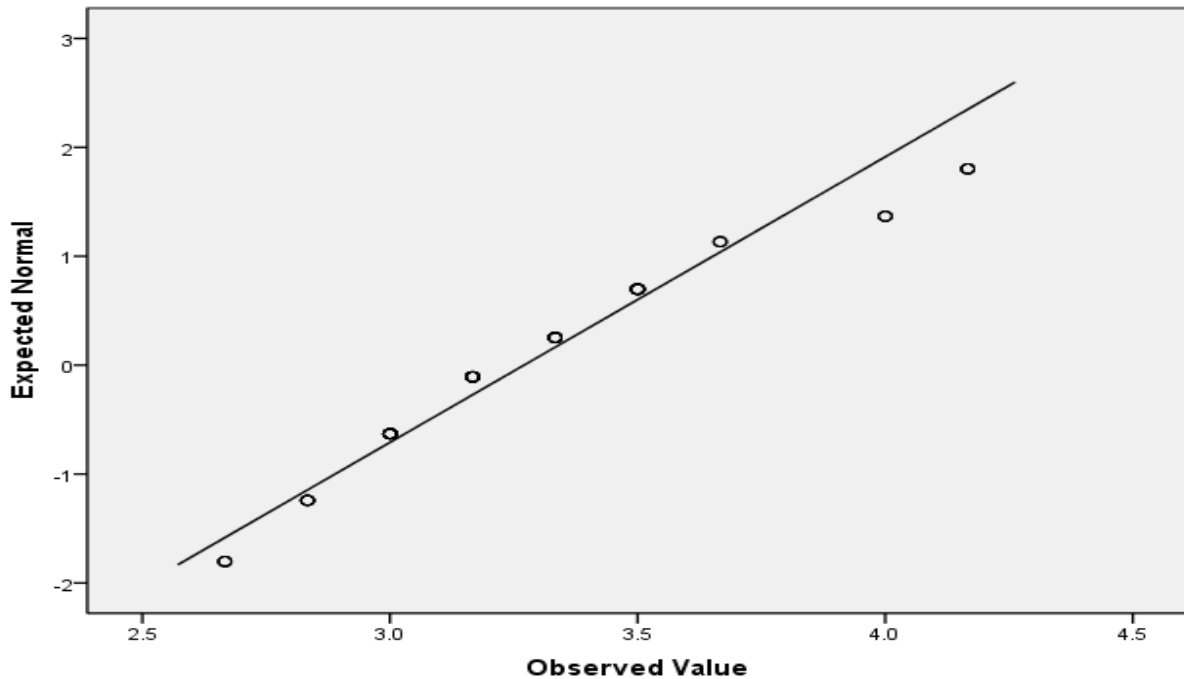
To determine factors affecting auditor independence, the linear regression analysis performed by using the statistical package for social science (SPSS) version 20. Before the results of this analysis, first let us look at the assumptions of the linear regression (Normality test, Multicollinearity test and Homogeneity test) to draw the accurate and reliable conclusion about reality.

4.3.1 Normality test

Statistical tools under the important assumption about the normality should be taken seriously, otherwise difficult to draw the accurate and reliable conclusion about the reality. The core element of the assumption of normality asserts that the distribution of survey cover means is normal. In technical points, this assumption of normality asserts that the covered audit firms' distribution of the mean is normal.

There are several methods for assessing the normality of observed data. It means that to check the observed data are normally distributed or not. These methods are classified in two broad categories. First category is associated with graphical test and second associated with statistical techniques. I used graphical test Quantile-Quantile (Q-Q) Plot Test for current study. Q-Q plot is a plot of the sorted values from the data set against the expected values of the corresponding quantiles from the standard normal distribution. In this test, correlation between data and normal quantiles (to measure the goodness of fit) measures how well the data is modelled by a normal distribution. For normal data the points plotted in the Q-Q plot should fall approximately on a straight line, indicating high positive correlation. These plots are easy to interpret and also have the benefit that outliers are easily identified (Ajay S. et al., 2014). Normality for this study Q-Q plot shown below in Figure 4.3.1

Figure 4.3.1 Normality Q-Q plot for auditor independence



Source: survey results

One of the important assumptions of linear regression is that the residuals are normally distributed, or put differently, the data are covered a normal population. The normal Q-Q plot is often used to provide a visual assess to this normality assumption. If normality holds, the Q-Q plot becomes linear or the plots of the observed scores against the predicted (normal) scores are expected to line up along the linear line

According to the Q-Q plot in Figure 4.3.1 seems to support the normality assumption that the distribution of data means is normal. Also, the situation when the scores are larger than 4 seems to be problematic; the plots fail to line up closer to the linear line (Ajay S. et al., 2014)

4.3.2 Multicollinearity test

Multicollinearity is an unacceptable high level of inter-correlation among the independent variables, such that the effect of the independents cannot be separated. I calculate the Variance

Inflation Factor (VIF) and Tolerance statistics to check for multicollinearity. Variance of inflation factor VIF may be used instead of tolerance as VIF is simply the reciprocal of tolerance.

Table 4.3.2.1 Variance inflection factors as a measure of Multicollinearity

| Model | Collinearity Statistics | |
|--------------------------|-------------------------|-------|
| | Tolerance | VIF |
| Audit Firm Sizes | .969 | 1.032 |
| Audit Market Competition | .893 | 1.119 |
| Tenure Audit | .843 | 1.186 |
| Size of Audit Fees | .885 | 1.130 |
| Non Audit Services | .889 | 1.125 |
| Audit Committee | .913 | 1.095 |

Source: survey results

The rule of thumb is that VIF is greater than 4 when multicollinearity is a problem. Some authors use the more lenient cut-off of $VIF \geq 5$ when multicollinearity is a problem. As we can see from Table 4.3.2.1, the VIF values computed for each independent variables are quite small, which indicates that there is no problem of multicollinearity because the VIF scores are less than 4 for all independent variables (G. David Garson, 2012).

Tolerance is defined as $1 - R^2$, where R^2 is the multiple R of a given independent regressed on all other independent variables. If the tolerance value is less than some cutoff value, usually 0.20, the independent variables have problem of multicollinearity. This is better than just using simple r greater than 0.80 since tolerance looks at the independent variable in relation to all other independents and thus takes interaction effects in to account as well as simple correlation G. David Garson, (2012).

4.3.3 Homogeneity test

Homogeneity of variance in regression may be assessed in several ways. One way is looking at the plots of the unstandardized predicted values against the unstandardized residual. If homogeneity holds, the points on the plot should line up uniformly along the horizontal line. In Figure 4.3.3.1, it seems there is more variation as move along the line from right to left.

I further look into this visual plot by means of formal statistical test for homogeneity. In this formal test, squared residual is regressed on predicted score, and the result of this analysis is shown in Figure 4.3.3.1. As we can see from this table, the regression coefficient is not significant. That is, no statistical effect is shown when regressing squared residual on predicted score, as we can see from the Figure 4.3.3.1 that the data supported the homogeneity assumption of the study.

Figure 4.3.3.1 Visual test to homogeneity

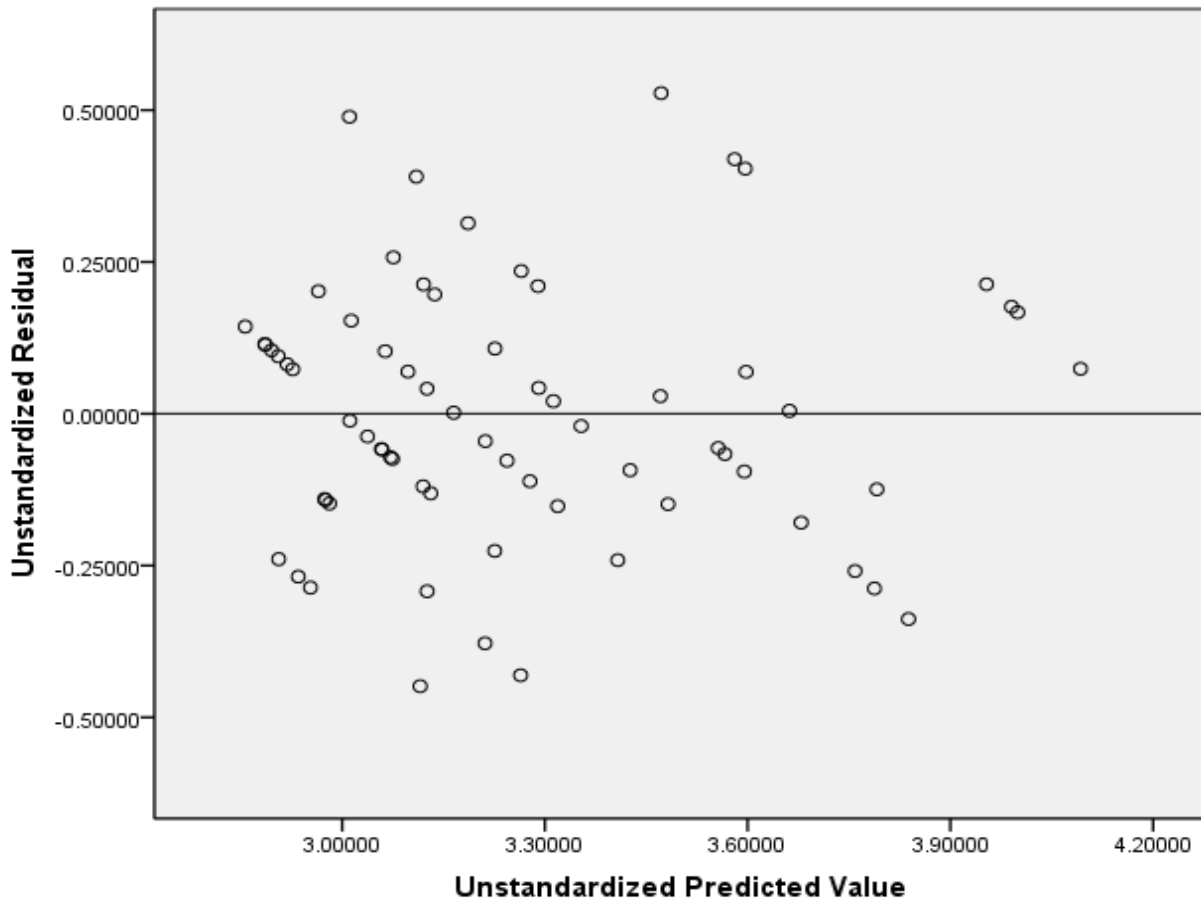


Table 4.3.3.1 Formal test to homogeneity

| Model | | Unstandardized | | Standardized | | t | Sig. |
|-------|-----------------------------------|----------------|------------|--------------|--|-------|------|
| | | Coefficients | | Coefficients | | | |
| | | B | Std. Error | Beta | | | |
| 1 | (Constant) | -.003 | .078 | | | -.044 | .965 |
| | Unstandardized Predicted Value | .015 | .024 | .076 | | .621 | .536 |

Dependent Variable: Squared residual. The non-significance of slope coefficient indicates that the patterns in the residual variation do not affect the dependent variable.

4.3.4 Main findings of the analysis

The results of the linear regression model are presented in Tables 4.3.4.1. The null model was significant ($F(6,62)=22.673$, $p \text{ value} < 0.05$) with the regression explaining 68.7 % of the variance in auditor independence. R-square adjusted for the number of independent variables is shown to be 0.657. Significance of .000 means strongly significant or more generally significant value less than 5% which is acceptable as shown in table 4.3.4.1 below

Table 4.3.4.1. Regression coefficients for independent variables identified to affect Auditor independence

| Model | Unstandardized | | Standardized | | |
|-----------------|----------------|------------|--------------|--------|------|
| | Coefficients | | Coefficients | | |
| | B | Std. Error | Beta | t | Sig. |
| Constant | 6.809 | .658 | | 10.355 | .000 |
| Audit Firm | .128 | .075 | .123 | 1.705 | .093 |
| Audit Market | -.535 | .064 | -.627 | -8.346 | .000 |
| Tenure Audit | -.407 | .088 | -.360 | -4.648 | .000 |
| Audit Fee | -.447 | .097 | -.348 | -4.605 | .000 |
| NAS | .183 | .073 | .189 | 2.514 | .015 |
| Audit Committee | -.070 | .107 | -.049 | -.655 | .515 |

Dependent Variable: Auditor independence

The regression analysis shows that which of the variables included in the regression model contributed to the prediction of the dependent variable. We find this information in the output box labeled Coefficients. Look in the column labeled Beta under Standardized Coefficients. To compare the different variables it is important that we look at the standardized coefficients, not the unstandardized ones. „Standardized“ means that these values for each of the different variables have been converted to the same scale so that we can compare them. If we were interested in constructing a regression equation, we would use the unstandardized coefficient values listed as B.

The Standardized Beta Coefficients measured the contribution of each variable to the model. Higher beta value would indicate a variation in independent variables resulted in significant changes in dependent variable. According to the Table 4.3.4.1, the standardized beta coefficients of all data are lower than 1. Look down the Beta column and find which beta value is the largest

(ignoring any negative signs out the front). The independent variable has the highest beta value of -0.627 is audit market competition at significant level of 0.000 which is less than 0.05. This is followed by Tenure Audit with a beta value of -0.360 at significant level of 0.000 which is less than 0.05, next size of Audit fees with a beta value of -0.348 at significant level of 0.000 which is less than 0.05 and NAS with beta value of 0.189 at significant level of 0.015 which is also less than 0.05. However, Size of audit firm with significant level of 0.093 which is more than 0.05 carried a beta value of 0.123 and finally existence of audit committee with significant level of 0.515 which is more than 0.05 carried a beta value of -0.049

4.4 Discussion of Findings

This study assessed the influence of audit firm size, level of competition within the external audit market competition, tenure of an audit firm serving the needs of a given client, size of audit fees received by audit firm in relation to total percentage of audit revenue, provision of non-audit service for audited client, and existence of audit committee on auditor independence. The summary result of hypotheses testing shown in table 4.4.1

Table 4.4.1: Summary Result of Hypotheses Testing

| Null Hypotheses | Hypotheses | Significant Level | Statistics Result |
|------------------------|---|--------------------------|--------------------------|
| H1 | Size of audit firm has no significant effect on auditor's independence. | .093 | accepted |
| H2 | The Level of competition in the Audit Service market has no significant effect on auditor's independence. | .000 | rejected |
| H3 | The tenure of an audit firm serving the needs of a given client has no significant effect on auditor's independence. | .000 | rejected |
| H4 | The size of audit fees received by audit firm in relation to total percentage of audit revenue has no significant effect on auditor's independence. | .000 | rejected |
| H5 | The provision of non-audit service has no significant effect on auditor's independence. | .015 | rejected |
| H6 | The existence of audit committee has no significant effect on auditor's independence | .515 | accepted |

Source: Developed for the research

4.4.1 Size of Audit Firm

The result from the data analysis shows that auditors perceived that size of audit Firm has not any significant effect on auditor's independence; this proves that the hypothesis (H1) is accepted. This result consistent with the previous study of Goldman & Barlev (1974), one should not conclude that large Audit firms are protected from pressures of their clients. More to the point, the few court cases which challenge the assumption that Audit firms acted independently indicate that the use of a large Audit firm is no guarantee of its ability to resist pressures from clients, as happened with Arthur Andersen and Enron. However, others studies that attempted to find the relationship between audit firm size and auditors' independence found that there is a positive relationship between audit firm size and auditors' independence, Larger audit firms are often considered to be more able to resist pressures from management (i.e. higher auditor's

independence), (DeAngelo, 1981b; Shockley & Holt, 1983; McKinley et al., 1985; Shockley, 1981; Gul, 1989; Alleyne et al., 2006; Abu Bakar et al., 2005).

The possible reason for audit firms' size has no effect on auditors' independence is that auditors believe that all audit firms whether they small or large they should be independent from audited client.

4.4.2 Level of Competition in the Audit Services Market

The result from the data analysis shows that auditors perceived level of Competition in the Audit Services Market has significant effect on auditor's independence; this proves that the hypothesis (H2) is rejected. This is because Level of Competition in the Audit Services Market has a significant negative effect on auditor independence. This result is consistent with the number of empirical studies have proven that the high level of competition in the audit firm has resulted in less auditor independence (e.g. Shockley, 1981; Alleyne et al., 2006; Abu Bakar et al., 2005).

However, Gul (1989), found the opposite argued that the existence of competition caused auditors to be more independent and create a favorable image in order to maintain their clientele. The possible reason for significant effect of Level of Competition in the Audit Services Market on auditor independence is that Firms operating in an intensely competitive environment may have difficulty remaining independent since there is a great option for client to replace one auditor with another easily, this affect the independence of auditors and create unfair market competition in the auditing industry.

4.4.3 Tenure of an Audit Firm Serving the Needs of a Given Client

The result from the data analysis shows auditors perceived Tenure of an Audit Firm serving the needs of a given Client has significant effect on auditor's independence; this proves that the hypothesis (H3) is rejected. This is because Audit Firm serving the needs of a given Client has a significant negative effect on auditor independence. This study consistent with the previous study of Alleyne et al., 2006; Abu Bakar et al., 2005, A long association between a corporation and an audit firm may lead to such close identification of the audit firm with the interests of its client's management that truly independent action by the audit firm becomes difficult (Mautz & Sharaf (1961). Rotation ensures that the auditor remains independent since tenure will be limited

and any vested interest will no longer be relevant (Teoh & Lim, 1996). In study conducted by Shockley (1981) however, tenure was not found to have a significant impact on perceptions of independence.

The possible reason for significant effect of tenure of an audit Firm serving the needs of a given Client on auditor independence is that audit firm works for a long period of time with one client create familiarity between auditor and client, this affect auditor independence.

4.4.4 Size of Audit Fees Received by Audit Firm

The result from the data analysis shows auditors perceived that size of audit fees received by audit firm in relation to total percentage of audit revenue has strong effect with auditor's independence; this proves that the hypothesis (H4) is rejected. This is because size of audit fee has a significant negative effect on auditor independence.

This result is consistent with the empirical studies of Abu Bakar et al. (2005), Ashbaugh et al. (2003), and Moore et al. (2002) which demonstrated the audit fees have a significant relationship with the auditor independence. Furthermore, in the research conducted by Abu Bakar and Ahmad (2009), it is evidenced from the study that size of audit fees is the most important factor in affecting auditor independence perceived by Malaysian accountants. EFAA (1998, p.4) also clearly states that, „the (total) fee from one client should not exceed a certain percentage of the total turnover of the audit firm.

Contrary to this study related to the size of audit fees study by Pany & Reckers (1983), noted that the large size of the client's audit fee (measured as a percentage of office revenues to the audit firm), though do not show any significant impacts on Perception of Auditor Independence.

The possible reason for significant effect of Size of audit fees received by audit Firm on auditor independence is that large audit fees paid by the client make the auditor more economically dependent on the audited client, and this affect auditor independence.

4.4.5 Provision of Non Audit Services

The result from the data analysis shows Ethiopian auditors perceived that provision of Non Audit Services has strong relationship with auditor's independence; this proves that the

hypothesis (H5) is rejected. This is because audit fees have a significant positive relationship with the auditor independence. This result is consistent with the empirical studies found a positive relationship between Non Audit Services provision and Auditor Independence (Goldwasser, 1999; Wallman, 1996).

According to Goldman and Barlev (1974) who support this view, the addition of management services increases the power and independence of the auditors. They argued that this occurs because most consulting-type services are non-routine and because these services benefit the client firm directly. Consequently, the replacement of the consulting auditor may result in a loss of valuable advice to the firm. The bargaining position, therefore, becomes stronger; s/he is better equipped to resist interference in the performance of auditing duties and is more likely to retain independence.

Studies of Barkess and Simnetts (1994) used data from different periods to investigate the association between the incidence of a going-concern opinion decision and NAF find that NAS fees are not related to the audit opinion decision. Craswell (2002) tests audit opinions and found that NAS fees are found to be not related to the audit opinion decision.

Contrary to this study early research related to financial statement users indicated that auditor independence is negatively affected when non-audit services are performed for audit clients (Abu-Bakar et al., 2005; Alleyne et al., 2006; Krishnan et al., 2005). They believe that these collateral services create a working relationship between the auditor and the client that is too close and that the provision of non-audit services negatively affected auditor's independence. Others studies that have shown that the provision of NAS has no effect on PAI, For example, McKinley et al. (1985) find that the provision of NAS did not significantly affect bank officers' PAI, their perceptions of financial statement reliability or their loan decisions. Coreless and Parker (1987) find similar results.

The possible reason for the provision of non-audit services has positive significant effect on auditor independence is NAS provision enhances the auditor's knowledge of the audited client, thus increasing the auditor's objectivity and auditors support this may be because of they benefited from NAS. The researcher suggests further study on this variable by different population.

4.4.6 Existence of Audit committees

The result from the data analysis of this study shows that auditors perceived Existence of Audit committee has not relationship with auditors' independence; this result accepted the hypothesis (H6). This result is consistent with the study of Gul (1989) finds that audit committees did not significantly affect the perceptions of auditor independence. On the contrary to this study there is much support to suggest a positive relationship between audit committees and auditor independence. Basically, a positive relationship between audit committees and AI means that the existence of an audit committee will enhance auditor's independence. Teoh and Lim (1996) in their study find that the formation of audit committees has a strong positive impact on enhancing auditor independence. Similarly, Patten and Nuckols (1970), Knapp (1985) and Lau and Ng (1994) find that the existence of an audit committee increases the likelihood of bankers' approving a loan, which is a reflection of an increased confidence in the auditor.

The possible reason for the existence of audit committee has no significant effect on auditor independence is that auditors believe whether audit committee exist or not, the auditor should be maintain their independence and the function of audit committee was may not know very well by auditors, the researcher suggests further study on this variable by different population.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

The aim of this chapter is to give a general summary about the whole study and make broad conclusions drawn from the findings of the results. Finally, based on the findings the researcher put some recommendations under this chapter.

5.1 Conclusions

This study assessed the influence of auditor firm size, level of audit market competition, tenure of audit firm serving the needs of a given client, size of audit fees received by audit firm in relation to total percentage of audit revenue, provision of Non-audit services and existence of audit committee on auditor independence.

The evidence from this study show that the Ethiopian auditors perceived strongly the following factors as important in influencing auditor's independence; they are, (1) level of market competition among audit firms, (2) tenure of an audit firm serving the needs of a given client, (3) size of audit fees received by audit firm in relation to total percentage of audit revenue, and (4) finally provision of non-audit services.

Factors including the level of competition among audit firms, an audit firm's tenure of service and the size of audit fees have negative effect on auditor independence. They tend to believe that an auditor's independence is more easily impaired in these three situations. Among the situations are when there is a higher level of competition among audit firms as compared to when the competition level is lower. Secondly, when there is a longer duration of service provided by the auditor for a given client as compared to when the auditor serves a given client over a shorter duration of time (auditor rotation). Thirdly, when there is a larger size of audit fees provided by the audited client to the auditor as compared to when the auditor receives a smaller size of audit fees. Finally, the provision of non-audit services has positive relationship with auditor independence. When there is Non-audit services (NAS) provided by the auditor to its audit client

the knowledge of auditors enhanced, thus increasing the auditor's objectivity as compared to when there is no provision of NAS by the auditor to its audited client.

Client based factors and industry specific factors are significant contributors on auditors' independence, resulting in to the economic dependence, credibility, allocation of resources, production, and economic effect.

5.2 Recommendation

Auditors' independence is a vital and provides high quality of auditing. This ensures the credibility of financial information not only for the purpose of reducing the number of corporate scandals but most importantly for the survival of audit profession and the development of healthy financial and capital market. As a result, the implications of the findings from this study lead the researcher to give the following recommendations

- Regulated and fair audit market should be maintained to the audit profession industry in Ethiopia to protect competitive pressures leading to lowballing /price cutting.
- To make audit fees to be fair, minimum audit fees should be decided depends on the size and the complexity of operations of the audited Client and the auditors need to be professionally liable for the unfair audit report produced by auditors.
- Too long association between the auditor and his client constitute a threat to independence as personal ties and familiarity may develop between the parties, which may lead to less vigilance on the part of the auditor and even to an obliging attitude of the latter towards the top managers of the company. There should be rotation of auditors to improve the auditors' independence. Drastic step would be require rotation of audit firms at regular intervals like 3 to 5 years

5.3 Scope for Further Research

This study focuses on the perceptions of Professional Auditors who serve in the various audit firms alone. There is the possibility of expanding the scope of future research on this subject on other stakeholders such as accountants working in the industries, staff members of internal audit, Board members of corporate organizations, managers of corporate organizations and Accounting Scholars who lecture in Universities should be integrated into future study on this

subject. This will result into more robust research findings on the factors affecting auditors' independence.

6. Bibliography

- Abdul Nasser, A.T., Syed Mustapha Nazri, S.N.F., &Hudaib, M. (2006). Auditor-client relationship: The case of audit tenure and auditor switching in Malaysia. *Managerial Auditing Journal*, 21 (7), 724-737.
- Abu-Bakar, N. B., and Ahmad, M. (2009), "Auditor Independence: Malaysian Accountants" Perception," *International Journal of Business and Management*, Vol. 4, No. 12, pp. 129-141.
- Abu-Bakar, N. B. (2006), "Threats to Auditors" Independence," *The Malaysian Accountant, Journal of the Malaysian Institute of Certified Public Accountants*, (December Issue), pp.3-5.
- Abu Bakar, N.B., Abdul Rahman, A.R., & Abdul Rashid, H.M. (2005). Factors influencing auditor independence: Malaysian loan officers" perceptions. *Managerial Auditing Journal*, 20 (8), 804-822.
- Adane wudu (2014). Auditor responsibility and fraud detection: In Ethiopian private audit firms. Presented in Partial Fulfillment of the Requirements for the Degree of Master of Science (Accounting and Finance) Addis Ababa University
- Ajagunna, B. (2012, August 8), "Unravelling the Fuel Subsidy Scandal," *The Punch*, pp. 4-5.
- Ajay S. Singh and Micah B. Masuku, (2014), Assumption and Testing of Normality for Statistical Analysis, *American Journal of Mathematics and Mathematical Sciences*
- Altman DG. and Bland JM, (1999) Measuring agreement in method comparison studies. *Statistical Methods in Medical Research*, 135-160.
- Alleyne,P.A., Devonish, D., &Alleyne, P., (2006), " Perceptions of auditors independence in Barbados", *Managerial Accounting Journal*, vol.21, N°6, pp.621-635.
- American Institute of Certified Public Accountants-AICPA (2015)Plain English Guide to Independence
- Andre, P., Broye, G., Pong, C., & Schatt, A. (2011). Audit fees, big four premium and institutional settings: The devil is in the details. Working paper, 1-26.
- Arens, A.A., Elder, R.J., and Beasley, M.S. (2012), *Auditing and assurance services: an integrated approach*. 14th ed. New Jersey: Pearson Education

- Ashbaugh, H., LaFond, R., and Mayhew, B. W. (2003), "Do Non-audit Services Compromise Auditors' Independence? Further evidence," *The Accounting Review*, Vol. 78, No. 3, pp. 611-639.
- Barkess, L., and Simnett, R. (1994). *The Provision of Other Services by Auditors: Independence and Pricing Issues*. *Accounting and Business Research*, Vol. 24, No. 94: pp. 99-108.
- Bartlett, R.W. (1993). A scale of perceived independence: New evidence on an old concept. *Accounting, Auditing & Accountability Journal*, 6 (2), 52-67.
- Beattie, V., Brandt, R. and Fearnley, S. (1999), "Perceptions of auditor independence: UK evidence", *Journal of International Accounting, Auditing & Taxation*, Vol. 8 No. 1, pp. 67-107.
- Blanche, M.T., Durrheim, K. and Painter, D. (2006) *Research in Practice* (2nd Ed), Cape Town, UTC Press.
- Bless, C & Higson-Smith, C. (2000). *Fundamentals of Social Research Methods: An African Perspective*, 3 ed. Cape Town: Juta.
- Chia-Ah, E., & Karlsson, J. (2010). *The impact of extended audit tenure on auditor independence: Auditors perspective*. Unpublished master's thesis, Umeå University, Umeå, Sweden.
- "Commercial Code Of The Empire Of Ethiopia Proclamation No. 166 Of 1960" (5th May 1960)
- Coreless, J.C. and Parker, L.M. (1987), "The impact of MAS on auditor independence: An experiment", *Accounting Horizon*, pp. 707-18.
- Craswell, A., D. Stokes, and J. Laughton. 2002. Auditor independence and fee dependence. *Journal of Accounting and Economics* 33 (2): 253–275.
- Cronbach L. Coefficient alpha and the internal structure of tests. *Psychometrika*. 1951;16:297-334.
- DeAngelo, L.E. (1981). Auditor independence, „low-balling“ and disclosure regulation, *Journal of Accounting and Economics*, Vol. 29, pp. 60-97.
- Deegan, C. and U, Jeffrey. (2011) *Financial accounting theory*. 2. European ed. Maidenhead: Mc Graw-Hill Education
- DeFond, M., RAghunandan, K. and Subramanyam, K. (2002), Do non audit service fees impair auditor independence? Evidence from going concern audit opinions, *Journal of Accounting Research*, Vol. 40 No. 4, pp. 1247-74.

Ethiopian Financial Reporting Proclamation 847/2014

European Federation of Accountants and Auditors. (1998). Position Paper Auditor Independence, EFAA, 1-29.

Firth, MA 1980, „Perceptions of auditor independence and official ethical guidelines“, The Accounting Review, vol.55, pp. 451-66.

G. David Garson, (2012). Testing statistical assumption, statistical Associates publishing

Gil S. Bae. Jae Eun Lee (2013). Does Audit Firm Size Matter.

Goldman, A., & Barlev, B., (1974), « The Auditor-Firm Conflict of Interests: Its Implications for Independence», The Accounting Review, vol. 49, N°4, pp.707-718

Gordon, N.J. (2003) Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley, Columbia Law and Economics Working paper no. 216

Goldwasser, D. L. (1999), “The Task awaiting the ISB,” Accounting Today, Vol. 7, pp.52-54.

Gul, F. (1989), “Bankers” perceptions of factors affecting auditor independence”, Accounting, Auditing & Accountability Journal, Vol. 2 No. 3, pp. 40-51.

Gul, F., & Tsui, J.S.L. (1992). An empirical analysis of Hong Kong bankers” perceptions of auditor ability to resist management pressure in an audit conflict situation, Journal of International Accounting, Auditing and Taxation, 1 (2), 177-190.

Hayes, R., Dassen, R., Schilder, A., & Wallage P. (2005). Principles of Auditing, An Introduction to International Standards on Auditing. Prentice Hall, 2nd ed. Millan.

Healy, P.M. and Palapu, K.G. (2003) “The Fall of Enron”, Journal of Economic Perspectives, Vol. 17. No. 2. pp. 3-26

Higson, A. (2003). Corporate financial reporting: theory and practice. Sage Publications Ltd.

<http://www.ofag.gov.et>

International Federation of Accountants (2010). IFAC Handbook. New York

John A. O. & Tasi, C.(2012), “Perceptions of Accountants on Factors Affecting Auditor’s Independence in Nigeria” International Journal of Research in Commerce, It & Management, Volume No. 2, ISSUE NO. 11

Knapp, M.C. (1985). Audit conflict: An empirical study of the perceived ability of auditors to resist management pressure. The Accounting Review, LX (2), 202-211.

Ko Sie Jian, Et At. 2012, An Investigation Into Big 4 Auditing Companies In Malaysia: Factors That Affect Auditor Independence

- Krishnan, J., Sami, H., & Zhang, Y. (2005). Does the provision of non-audit services affect investor perceptions of auditor independence? *Auditing: A Journal of Practice and Theory*, 24 (2), 111-135.
- Lau, P.T.Y., & Ng, P.P.H. (1994). The impact of audit committee and client financial condition on bankers' loan decisions. *Asia-Pacific Journal of Accounting*, pp 19-28.
- Lukas Beyashe, (2014). Challenges Faced by Ethiopian Federal Government Auditors: the Case of the Office of the Federal Auditor General
- Mansi, S.A., Maxwell, W.F., and Miller, D.P., 2004. Does auditor quality and tenure matter to investors? Evidence from the bond market. *Journal of Accounting Research*, 42 (2), 755-793.
- Mautz, RK & Sharaf, HA (1961), the philosophy of auditing, Sarasota, FL: American Accounting Association.
- McKinley, S., Pany, K. and Reckers, P.M.J. (1985), "An examination of the influence of CPA firm type, size, and MAS provision on loan officer decisions and perceptions", *Journal of Accounting Research*, Vol. 23 No. 2, pp. 887-96.
- Messier, W.F. and Boh, M. (2002) *Auditing and Assurance services in Malaysia* 2nd Ed. McGraw- Hill, Malaysia
- Moore, D., Tetlock, P.E., Tanlu, L., & Bazerman, M. (2006). Conflicts of interest and the case of auditor independence: Moral seduction and strategic issue cycling. *Academy of Management Review* 31, 10-29.
- Mugenda, Olive M. and Mugenda, Abel G. (1999) *Research Methods: Quantitative and Qualitative Approaches* Publisher African Centre for Technology Studies
- Mulneh beyene, 2007, *Auditors Professional Responsibilities and Legal Liability with Regard to Private Auditors in Ethiopia*, Addis Ababa university, Addis Ababa.
- Pany, K. and Reckers, P.M.J. (1980). The effects of gifts, discounts and client size on perceived auditor independence, *The Accounting Review*, Vol. LV No. 1, pp. 50-61.
- Paten, R.J., & Nuckhols, J.R. (1970). Competence and Independence- The issue of management services. *The Louisiana Certified Public Accountant*, Fall, 20-30.
- Rittenberg, L.E., Schwieger, B.J., and Johnstone, K.M., 2008. *Auditing: a business risk approach*. 6th ed. Ohio: Thomson South-Western.

- Robert K. Elliott and Peter D. Jacobson (1998), Audit independence concepts, *The CPA Journal* 68 no12 30-4+ D '98
- Robert Nau, 2014 “Notes on linear regression analysis”
- Salehi, M., Mansoury, A., and Azary, Z. (2009), “Audit Independence and Expectation Gap: Empirical Evidence from Iran,” *International Journal of Economics and Finance*, Vol. 1, No. 1, pp. 165-174.
- Shafie, R., Hussin, W. N. W., Yusof, M. A. M., & Hussain, M. H. M. (2009). Audit firm tenure and auditor reporting quality: Evidence in Malaysia. *International Business Research*, 2(2), 99-109.
- Shockley, R.A. (1981). Perceptions of auditors’ independence: An empirical analysis. *The Accounting Review*, LVI (4), 785-800
- Shockley, R.A., & Holt, R.N. (1983). A behavioral investigation of supplier differentiation in the market for audit services. *Journal of Accounting Research*, Autumn, 545-564.
- Struwig, F. W. & Stead, G. B. 2001. *Planning, designing & reporting research*. Cape Town: Maskew Miller Longman.
- Teoh, H.Y. and Lim, C.C. (1996), “An empirical study of the effects of audit committees, disclosure of nonaudit fees and other issues on audit independence: Malaysian evidence”, *Journal of International Accounting, Auditing and Taxation*, Vol. 5 No. 2, pp. 231-48.
- Titus M., Willy M. & John K., (2014) “Factors Affecting External Auditors’ Independence in Discharging their Responsibilities: A Survey Of Medium Level Auditing Firms in Nairobi” *International Journal of Business & Law Research* 2(4):22-35
- Wallin, D.E., 1992. Legal recourse and the demand for auditing. *The Accounting Review*, 67 (1), 121-147.
- Wines, G. (2011) Auditor independence shared meaning between the demand and supply sides of the audit services market? *Managerial Auditing Journal* Vol. 27. No. 1. pp. 5-40
- World Bank (2007) “Report on the Observance of Standards and Codes on Accounting and auditing /ROSC/”.
- Yost, A. J., (1995). Auditor Independence as a Unique Equilibrium Response. *Journal of Accounting, Auditing and Finance*, (winter), 10(1):81-102.
- Zikmund, W. G. (2003). *Business research methods* (8th ed.). Ohio: Thomson-South-Western.

APPENDIX(1)

ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE
MSc IN ACCOUNTING AND AUDITING

Survey Questionnaire for Audit Firms

This questionnaire is for a master's study entitled "factors affecting external Auditors independence in Ethiopia Audit firms". The study is purely intended for academic purpose and is for the partial fulfillment for the award of master's degree in Addis Ababa University. You have been selected to participate in this study due to the importance of your information in the study. The information you provide will only be used for the purpose of this study and will be treated with utmost confidentiality. Please feel free and answer all the questions truthfully, the questionnaire fulfilled by General Manager, Audit manager and senior auditor. Thanks for your cooperation in answering the questionnaire by sacrificing your valuable time. For further information, please contact Shumi Waktola by the following address:

Section A:

Demographic Background

Please kindly tick (X) your answer in the appropriate boxes or respond by writing if required.

1. Gender: Female Male

2. Age: 20-30 years old 31-40 years old Above 40 years old

3. The highest education level

TVET, Diploma Bachelor's degree

Master's degree other (please specify) _____

4. Years of work experience:

Less than 5 years'' 11 - 20 years''

6 - 10 years'' Over 20 years''

5. The level (grade) of your Audit Firm

A B C

6. Current position in your Audit firm: _____

Section B:

In this section the researcher is seeking your specific perceptions towards **factors affecting auditors' independence in Ethiopia audit firms**. Please kindly indicate the appropriate scale for your opinion by ticking (X) on the spaces that indicate your choice from the options that range from **strongly Disagree (SD), Disagree (D), Neutral (N), Agree (A), ,strongly Agree (SA)**,

| NO | Questionnaires | Strongly Disagree (SD) | Disagree (D) | Neutral (N) | Agree (A) | Strongly Agree (SA) |
|-----------|---|-------------------------------|---------------------|--------------------|------------------|----------------------------|
| A | Auditor independence | 1 | 2 | 3 | 4 | 5 |
| 1 | The value of auditing depends heavily on the independence of auditors in mind and appearance | | | | | |
| 2 | Auditors exercise their independence as an auditors in their audit Firms during the audit duties | | | | | |
| 3 | Audit firms support auditors independence when undertaking audit duties | | | | | |
| 4 | Client makes significant gifts to auditors | | | | | |
| 5 | Reliable audit report performed by independent auditors are very important for financial statements users | | | | | |
| 6 | Independence and Competence of Auditor is the reason for the existence of auditing profession that provides audit service | | | | | |
| B | Size of Audit Firm | SD | D | N | A | SA |
| 7 | Audit firm size is a strong reason to cause external auditors to lose their | | | | | |

| | | | | | | |
|----------|--|-----------|----------|----------|----------|-----------|
| | independence | | | | | |
| 8 | Large audit firms (eg. grade A) can maintain their independence without any interference because of their financial strength | | | | | |
| 9 | Revenues and the number of offices have significant effect on audit firm's size and Auditor independence. | | | | | |
| 10 | Human capital (Education level, work experience, skills, and Employee competence) is effect on audit firm and audit quality | | | | | |
| 11 | The numbers of audit professional are effects on audit firms and audit quality | | | | | |
| 12 | Small Audit firms cannot resist management pressure due to their financial weakness | | | | | |
| C | Level of Competition in the Audit Services Market | SD | D | N | A | SA |
| 13 | There is fair level of Competition in the Audit Services Market in our country | | | | | |
| 14 | Audit Firms operating in an intensive competitive environment may have difficulty to maintaining their independence | | | | | |
| 15 | Audit Firms operating in an intensive competitive environment have more independent in order to maintain their customers | | | | | |
| 16 | The intensive level of Competition in the Audit Services industry exposed | | | | | |

| | | | | | | |
|----------|--|-----------|----------|----------|----------|-----------|
| | the audit profession to opinion shopping | | | | | |
| 17 | Low-balling and price-cutting affects the independence of external auditors | | | | | |
| D | Audit firms tenures | SD | D | N | A | SA |
| 18 | The length of time the auditor has served the company (Client) has an effect on the auditors independence | | | | | |
| 19 | Audit firms tenure giving audit services (eg. more than 5 years) for one client impair (loss) auditors independence | | | | | |
| 20 | Long tenure of an Audit Firm serving the needs of a given client has enhance Auditors independence | | | | | |
| 21 | Short term Audit tenure (Rotation per 5 years) in auditing client is enhancing auditors independence | | | | | |
| 22 | It is much easier for the management to influence the operations of the auditors with whom they have worked with for a long time and hence compromise their independence | | | | | |
| 23 | Auditor's income depends on retention of a specific client | | | | | |
| E | Size of Audit Fees | SD | D | N | A | SA |
| 24 | Large size of audit fees is normally associated with a higher risk of losing the auditor's independence | | | | | |
| 25 | The auditors independence is dependent on the audit fee they are able to charge their clients | | | | | |
| 26 | Large size of audit fees has enhanced auditor independence | | | | | |

| | | | | | | |
|----------|---|-----------|----------|----------|----------|-----------|
| 27 | When the audit fees is charged as per the competition in the audit services market it encourages high auditor independence because the clients can't shift. | | | | | |
| 28 | Your audit firm Audit fee is low compared to other non-audit fees | | | | | |
| F | Non Audit Services (NAS) | SD | D | N | A | SA |
| 29 | Audit firms should be allowed to perform non-audit services for their audit client | | | | | |
| 30 | Non-audit services impaired (loss) the independence of external auditors. | | | | | |
| 31 | Non Audit services provision enhances the auditor's knowledge of the client. | | | | | |
| 32 | Financial statements of audit firms should clearly disclose how much is earned from non-audit service | | | | | |
| 33 | Audit firm Non-audit services revenues are more than 25% of audit fees | | | | | |
| 34 | Restrictions on non-audit services may enhance investor perception of auditor independence, and their confidence and trust in audits | | | | | |
| G | Existence of Audit committee | SD | D | N | A | SA |
| 35 | The existence independent audit committees has an effect on the level of auditors independence | | | | | |
| 36 | The audit committee is charged with the responsibility of ensuring that the auditors are able to present the most appropriate, true and fair audit report | | | | | |

| | | | | | | |
|----|---|--|--|--|--|--|
| 37 | A strong and independent audit committee ensures that the auditors act independently during the audit of financial statements | | | | | |
| 38 | Audit committee can play the arbitration role between auditors and management when there is disagreement between them | | | | | |
| 39 | Audit committee is independent of directors or owners | | | | | |

Thank you for your valuable time, opinion and comments.