



**THE ROLE OF EXTERNAL AUDITORS IN ENHANCING INVESTOR CONFIDENCE:  
THE CASE OF SELECTED AUDIT FIRMS AND THEIR CLIENTS.**

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## TABLE OF CONTENTS

<b>LIST OF TABLES</b> .....	iv
<b>LIST OF ACRONYMS</b> .....	v
<b>ACKNOWLEDGEMENT</b> .....	viii
<b>ABSTRACT</b> .....	ix
<b>CHAPTER ONE</b> .....	1
<b>1. INTRODUCTION</b> .....	1
<b>1.1 Background of the Study</b> .....	1
<b>1.2 Statement of the problem</b> .....	3
<b>1.3 Research Questions</b> .....	5
<b>1.4 Objective of the Study</b> .....	5
1.4.1 General Objective of the Study.....	5
1.4.2 Specific objective of the Study.....	5
<b>1.5 Research Hypothesis</b> .....	5
<b>1.6 Significance of the Study</b> .....	6
<b>1.7 Scope/ Delimitation of the Study</b> .....	7
<b>1.8 Limitation of the Study</b> .....	8
<b>1.9 Operational Definition of the Study</b> .....	8
<b>1.10 Organization of the Study</b> .....	9
<b>CHAPTER TWO</b> .....	11
<b>RELATED LITERATURE REVIEW</b> .....	11
<b>2. Introduction</b> .....	11
<b>2.1 Theoretical Literature Review</b> .....	11
2.1.1 The Role of External Auditors in Enhancing Investor Confidence .....	11
2.1.1.1 Enhancing transparency in Financial Reporting.....	12
2.1.1.2 Strengthening Accountability and Governance .....	13
2.1.1.3 Mitigating Fraud and Financial Risks.....	14
<b>2.1.2 Underpinning Theories Relevant to Auditing</b> .....	15
2.1.2.1 Agency Theory and Its Relevance to Auditing .....	15
2.1.2.2 Stakeholder Theory and the Importance of trust in Financial Reporting. ....	16

<b>2.1.3 Determinants of Investor Confidence</b> .....	17
2.1.3.1 Audit Independence.....	17
2.1.3.1.1 Dimensions of Audit Independence.....	18
2.1.3.1.2 Threats to Audit Independence .....	18
<b>2.1.3.2 Audit Transparency</b> .....	20
2.1.3.3 Audit Firm Reputation.....	23
2.1.3.4 Financial Reporting Quality.....	25
<b>2.2 Empirical Literature Review on The Role of External Auditors.</b> .....	28
2.2.1 Impact on Financial reporting and Market response.....	28
2.2.2 The Impact of Independence on Financial Statement Credibility.....	28
2.2.3 Enhancing Corporate Governance Through Audits. ....	28
2.2.4 Addressing the expectation Gap.....	29
2.2.5 The Impact of auditor Autonomy on Financial reporting .....	29
2.2.6 Audit Opinions and Investor perception.....	30
<b>2.3 Conceptual Framework of The Study</b> .....	30
<b>2.4 Conclusion and Knowledge Gap</b> .....	31
<b>CHAPTER THREE</b> .....	33
<b>RESEARCH METHODOLOGY OF THE STUDY</b> .....	33
<b>3.1 Research Approach</b> .....	33
<b>3.2 Research Design</b> .....	33
<b>3.3 Units of Analysis</b> .....	34
<b>3.4 Data Type and Sources</b> .....	34
<b>3.5 Target population and Sample Size Determination</b> .....	35
3.5.1 Target Population.....	35
3.5.2 Sample Size Determination.....	36
<b>3.6 Sampling Techniques</b> .....	36
<b>3.7 Methods of Data Collection</b> .....	37
<b>3.8 Methods of Data Analysis</b> .....	37
<b>3.9 Ethical Consideration</b> .....	39
<b>CHAPTER FOUR</b> .....	40
<b>DATA PRESENTATION AND DATA ANALYSIS</b> .....	40
<b>4 INTRODUCTIONS</b> .....	40

<b>4.1 Response Rate</b> .....	40
4.2 Reliability Test Result .....	41
<b>4.3 Descriptive Statistics Analysis</b> .....	42
<b>4.3.1 Demographic Characteristics of Respondents</b> .....	42
4.3.2 Descriptive Statistics Analysis for Audit Independence .....	44
<b>4.3.3 Descriptive Statistics Analysis for Audit Transparency</b> .....	45
<b>4.3.4 Descriptive Statistics Analysis for Audit firm Reputation</b> .....	46
<b>4.3.5 Descriptive Statistics Analysis for Financial Reporting Quality</b> .....	47
<b>4.3.6 Descriptive Statistics Analysis for Investor Confidence.</b> .....	48
4.3.7 Examination of Audited Financial statements. ....	48
<b>4.5 Descriptive Analysis of Correlation</b> .....	52
<b>4.6 Parametric Statistical Assumptions</b> .....	53
<b>4.6.2 Multicollinearity</b> .....	53
<b>4.6.3 Heteroscedasticity</b> .....	54
4.6.4 Normality .....	55
<b>4.5.4 Ramsey RESET test</b> .....	56
<b>4.6 Multiple Regression Analysis</b> .....	57
<b>4.6.1 Model of regression Summary</b> .....	57
<b>4.6.2 ANOVA</b> .....	58
<b>4.6.3 Regression Coefficients</b> .....	59
<b>4.7 Interpretation of Regression Analysis in Terms of Research Hypotheses.</b> .....	59
<b>CHAPTER FIVE</b> .....	61
<b>SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION</b> .....	61
<b>5. INTRODUCTIONS</b> .....	61
<b>5.1 Summary of Findings</b> .....	61
<b>5.2 Conclusion</b> .....	62
<b>5.3 Recommendations</b> .....	63
<b>6. REFERENCE</b> .....	65
<b>7. ANNEXES</b> .....	71

## LIST OF TABLES

Table 4.1: Response Rate.....	40
Table 4.2: Reliability Test Result .....	41
Table 4.3: Demographic Characteristics.....	42
Table 4.4: Descriptive Statistics Analysis for Audit Independence.....	45
Table 4.5 Descriptive Statistics Analysis for Audit Transparency.....	45
Table 4.6 Descriptive Statistics Analysis for Audit Firm Reputation.....	46
Table 4.7 Descriptive Statistics Analysis for Financial Reporting Quality.....	47
Table 4.8 Descriptive Statistics Analysis for Investor Confidence.....	48
Table 4.9: Correlation Analysis.....	52
Table 4.10: Multicollinearity Test.....	54
Table 4.11: Heteroscedasticity Test.....	55
Table 4.12: Normality Test.....	55
Table 4.13: Ramsey RESET Test.....	56
Table 4.14: Model summary.....	57
Table 4.15: ANOVA.....	58
Table 4.16: Regression Coefficients.....	59

## LIST OF FIGURES

	Page
2.1 Conceptual Frameworks of the Study.....	31

## **LIST OF ACRONYMS**

AABE: Accounting and Auditing Board of Ethiopia

ACCA: Association of Chartered Certified Accountants

CAMs: Critical Audit Matters

EARs: Enhanced Audit Reports

ESG: Environmental, Social and Governance

IASB: International Accounting Standard Board

IFRS: International Financial Reporting Standards

IIA: Institute of Internal Auditors

ISA: International Standard on Auditing

KAMs: Key Audit Matters

NAS: Non-Audit Services

NBE: National Bank of Ethiopia

OECD: Organization for Economic Co-operation and Development

PCAOB: Public Company Accounting Oversight Board

SDG: Sustainable Development Goals

SOX: Sarbanes-Oxley Act

STATA: Statistical Software Package used for Data Analysis

## Statement of Declaration

I Semeneh Agama, hereby declare that this thesis is the result of my own independent work. To the best of my knowledge and belief it does not contain any material previously published or written by another individual except where proper citation and acknowledgment are provided. I also confirm that no portion of this thesis has been submitted previously by me or anyone else for the award of a degree at this or any other academic institution.

Name: Semeneh Agama

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Place: Addis Ababa

Date of Submission: 8 June 2025

**ADDIS ABABA UNIVERSITY**

**SCHOOL OF COMMERECE**

This is to certify that the thesis carried out by Semeneh Agama under the supervision of Dr. Mengistu Bogale entitled “ The Role of External Auditors in Enhancing Investor Confidence: The Case of Selected Audit firms and Their Clients” and submitted in partial fulfillment of the requirements of the Degree of Master of Science in Corporate Finance-Specialty in Investment Management complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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## ABSTRACT

This study examines the role of external auditors in enhance investor confidence focusing on selected partnership audit firms and their client's in Addis Ababa. Utilizing a quantitative survey methodology. The research examines four critical determinants: audit independence, audit transparency, audit firm reputation and financial reporting quality and analyzed using multiple regression analysis. Finding indicates that audit independency, audit transparency and financial reporting quality significantly enhance investor confidence and consistent with established audit quality standard. However, the audit firm reputation appears to exert minimal influence potentially due to the majority of smaller audit firms within Ethiopia audit practice. Descriptive statistics reveal a moderate level of trust in auditor's independence and transparency but highlight concerns regarding the financial reporting quality and inconsistent ethical practices. Challenges in implementing International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) are primarily associated with inadequate expertise and insufficient regulatory oversight. The study proposes that the Accounting & auditing Board of Ethiopia (AABE) enforces stricter guidelines to safeguard auditor's independence obligatory Key Audit Matters disclosures to enhance transparency and promote compriehensive IFRS training to improve reporting standards. Future research should incorporate sole proprietorship audit firms and additional elements such as technological adoption in auditing practice and regulatory compliance to improve the understanding of Ethiopian's audit sector for increasing investor trust.

**Keywords:**Accounting & Auditing Board of Ethiopia (AABE), Audit Firm Reputation, Audit Independence, Audit Transparency, Ethical Practices, External Auditors, Financial Reporting Quality, Investor Confidence, Key Audit Matters, Regulatory Compliance, Partnership Audit Firm.

## **CHAPTER ONE**

### **1. INTRODUCTION**

This Chapter introduces the study by outlining its foundation context and assumptions. It presents a comprehensive overview that includes the background and rationale of the research, statement of the problem, key research questions, objective, hypotheses and significance of the study. Additionally, it defines key terms, describe the scope and explains the structure of the entire paper. The chapter begins by providing the background to the study which focuses on examining the role of external auditors in enhancing investor confidence.

#### **1.1 Background of the Study**

The assurance of investors holds significant weight for stimulating economic growth and preserving the integrity of financial markets. Investors both domestic and international participants, depend on financial statements to evaluate the financial health and potential risks associated with various Company. External auditors play a vital role in guaranteeing that this financial statement is dependable, transparent and precise by offering an independent and objective evaluation External auditors act as intermediaries between entity and investors there by develop trust in the financial information that is disclosed Ray (2012).

Investor confidence is fundamental for the stability and advancement of financial markets. External auditors play a significant role in enhancing investor confidence through the verification of the accuracy and trustworthiness of financial statements. Their contribution assists in alleviating information asymmetry and offer assurance to investors concerning the clarity of financial disclosures. Auditors fulfill a fundamental function in detecting and lessening the misappropriation of assets by corporate insiders, thus safeguarding the interest of investors Newman, Patterson & Smith (2003).

According to Wang, Xie, Yan & Zhang (2024) the provision of reliable and transparent financial statements is important to engage in well-informed decision-making particularly emerging economies. External auditors play a crucial role in boosting investor confidence by delivering

independent evaluation that confirm the accuracy and integrity of financial Statements. Investors respond a distinct reaction to auditor-related information such as the identity of auditors and any alterations in signing auditors which underscores their dependence on perceived audit quality as a basis for trust in financial reports. Wang et al. (2024) emphasize the essential function of external auditors in mitigating the trust gap that exist between companies and their investors.

Research indicate that audit opinions exert a significant influence on investor behavior Karkacier and Ertaş (2017) emphasize that unqualified audit function as a solid indicator of strong financial health and transparency whereas adverse or qualified opinions may discourage investments. The dependability of audit reports holds particular significance for institutional investors who depend on such evaluation to assess risk and profitability.

The perception of audit quality is further supported when audits are conducted by prominent audit firms Karkacier and Ertaş (2017) discovered that investors correlated audits performed by respected firms such as the “Big Four” with enhanced reliability and credibility. This underscores the critical role of auditor’s reputation in developing trust and promoting investment in financial markets.

Auditors play a vital function in enhancing investor confidence by verifying the reliability and transparency of financial statements. External auditors fulfill an essential governance function by alleviating agency conflicts that may arise between controlling owners and minority shareholders Fan and Wong (2001). Auditors assure investors the faithfulness’ and clarity of a company financial Statements enhancing trust while lessening information discrepancies.

The independency and quality of auditors are fundamental to the investor trust. Fan and Wong (2001) state that reputable auditors to impose premium fees and establish more rigorous criteria for audit modifications when engaging with clients who exhibits significant agency conflicts these practices serve as indicators of the auditor’s dedication to providing high-quality assurance which is crucial for investor confidence particularly in markets characterized in weak regulatory oversight. This study examines the role of external auditors in enhancing investor expectation within the Ethiopia by investigating factors such as audit independency, audit transparency, audit firm reputation and Financial reporting quality.

The concept of independency is paramount in the preservation of audit quality. The necessity for external auditors to operate absent of conflict of interest in order to ensure their assessments remain impartial. Independence substantially supports the credibility of audits that increasing reliability for stakeholders ACCA (2016). This principle holds particular significance in Ethiopia, where stimulating auditor's independency can directly enhance trust in financial reporting. High-quality audit mitigates the risk of financial misstatement and fraudulent activities consequently development trust among investors and other stakeholders El-Faki ( 2013).

## **1.2 Statement of the problem**

External auditors act as a critical governance mechanism by independently reviewing and evaluating a company financial statements and internal controls to prevent material misstatements ensuring the reliability of financial information Markby ( 2022). This function is essential for investors who depend on audited financial statements to assess the financial health and risks of potential investments Porter, Simon, & Hatherly (2003). However, challenges such as inconsistent audit practices and limited regulatory oversight pose significant barriers to achieving trust on financial reports Guillán Montero & Le Blanc ( 2019).

The problem intensified by the global rise in economic crises, Corporate failure and fraudulent activities which have amplified the need for strong external audit functions Yajie (2015). In Ethiopia where financial frameworks and regulations are still evolving the integrity and independency of auditors are crucial determinants of investor trust Beyene (2007). High quality audits reduce the incidence of fraud and financial misstatements providing stakeholders with assurance that financial statements are accurate and compliance with international standards Kassem & Higson (2016). However, studies indicate that Ethiopian audit practice often suffer from inadequate expertise and weak enforcement of ethical standards undermining the credibility of audit reports Mihret (2010) this gap in audit quality directly impacts investor perception potentially discouraging investment and hindering economic development Kesto & Bayeh (2021).

Factors such as economic dependence on major clients, political influences and limited regulatory oversight threaten auditors objectivity reducing the reliability of their assessments Guillán

Montero & Le Blanc (2019). Consequently the perceived lack of auditors independence can erode investor confidence limiting the effectiveness of audits in bringing the trust gap between companies and investors Ojo (2006).

Transparent audit reports that clearly disclose methodologies, Key audit matters and financial risks are essential for enabling informed decision-making Chen, Jiang & Zhang (2014). However, inconsistent application of international financial reporting standards (IFRS) and international Standards on Auditing (ISA) due to limited expertise and regulatory gaps often results in financial statements lacking clarity or reliability Kesto & Bayeh (2021) these deficiencies increase information asymmetry making it difficult for investors to trust the provided financial information Adeleye (2022).

Few Studies have specifically examined how audit independency, transparency and financial reporting quality influence investor confidence in Ethiopia Beyene (2007) and Mihret (2010). This research gap highlights the need for a comprehensive study to provide actionable insights for improving audit quality practice and ethical compliance among auditors Kesto & Bayeh (2021).

While, a lot of research has been conducted on the role of external auditors in enhancing investor confidence in developed and other markets there is a significant gap in understanding how these dynamics play out in Ethiopia's unique regulatory and economic context. Based on the researcher's understanding there is a lack of comprehensive studies in Ethiopia that specifically examine the role of external auditors in enhancing investor confidence. Existing research has tended to focus separately on factors such as audit quality, transparency and independency. This study aims to address this gap by integrating key determinants audit independency, audit transparency, audit firm reputation and financial reporting quality to investigate how external auditors contribute to strengthening investor confidence.

### **1.3 Research Questions**

To achieve the research objective research questions are designed to provide a through comprehensive understanding of the investor confidence in Ethiopia and identify areas where auditing practices can be improved. These are:

1. To what extent does the independence of external auditors enhance investor confidence?
2. How does the level of transparency in audit reports influence investor Confidence?
3. To what extent does reputation of audit firms impact investor confidence?
4. How does the preparation of high-quality financial reports enhance investor Confidence?

### **1.4 Objective of the Study**

#### **1.4.1 General Objective of the Study**

The general objective of this study is to analyze the function of external auditors in enhancing investor confidence.

#### **1.4.2 Specific objective of the Study**

1. To assess the extent to which the independence of external auditors enhances investor Confidence.
2. To analyze how the level of transparency in audit reports affects investor confidence.
3. To evaluate the impact of audit firm reputation on investor confidence
4. To evaluate the quality of financial reporting and its effect on investor Confidence.

### **1.5 Research Hypothesis**

According to Frankel (1979) a hypotessis is a tentative statement of fact that awaits verification through research. To achive the objective of this study a comprehensive review of related literature was conducted to identify the key factors that determine investor confidence. Based on this review four determinants were recognized: audit independence, audit transparency, audit firm reputation and financial reporting quality. Accordingly the folloeing research hypotheses

have been developed to examine the relationship between these variables and investor confidence.

1. H1: Auditor independence positively influences investor confidence
2. H2: Higher transparency in audit reporting increases investor confidence in Financial Statements.
3. H3: The reputation of the audit firm positively influences investor confidence in the reliability of financial statements.
4. H4: The quality of financial reporting increases investor confidence in Financial Statements.

### **1.6 Significance of the Study**

This research possesses considerable significance for diverse stakeholders within Ethiopia's commercial and investment especially as the country seeks to enhance its financial reporting standards and attract investment. By investigating the function of external auditors in supporting investor confidence the study contributes good understanding of how audit quality, independence, and transparency affect investor trust in financial statements. The outcomes are anticipated to assist policymakers, regulator body and business entity in establishing a stronger and more transparent financial environment.

The research offers critical understandings for policymakers and regulatory authority areas where auditing standards and regulatory frameworks could be improved. By identifying factors that contribute to investor confidence the study can inform enhancements in policy aimed at development a more dependable and efficient audit profession within Ethiopia and relevant to integrate international financial reporting standards and improve its governance practices.

For both domestic and international investors the study helps as a framework for more effectively evaluating the dependability of financial systems. By inspecting how audit quality affects investor trust and the study allows investors to make more informed decisions.

External auditors and audit firms benefits that the study highlighting clarifying essential factors that increase investor trust. Getting the influence of audit quality and independence on investor

perceptions enables audit firms to customize their methodologies to align with investor expectations and enhance their professional reputation. Understandings to the challenge of confronting Ethiopian auditors can further facilitate audit firms and professional organization in addressing this obstacle and work towards higher standards.

Ultimately this research contributes to the academic domain of accounting and finance by addressing a gap in the literature concerning audit practice & investor confidence in Ethiopia and also this research will lay the groundwork for future study aiding Scholars and students in understanding the relationship between audit quality and investor trust.

### **1.7 Scope/ Delimitation of the Study**

This study focuses on examining the role of external auditors in enhancing investor confidence within the context of Addis Ababa's business environment specifically targeting selected partnership audit firms and their clients. The research is delimited to four key variables audit independence, audit transparency, audit firm reputation and financial reporting qualities to assess their impact on investor confidence involving stakeholders such as external auditors, finance managers, general manager and regulatory bodies the Accounting and Auditing Board of Ethiopia (AABE). By identifying factors that contribute to investor confidence the study can inform enhancements in policy aimed at development a more dependable and efficient audit profession within Ethiopia and relevant to integrate international financial reporting standards and improve its governance practices.

The scope is further delimited by its quantitative survey methodology collecting data from sample selected respondents to provide empirical understandings on auditing practices in Ethiopia's. The study excludes sole proprietorship audit firms and other variables like regulatory compliance due to time, resource and data availability constraints focusing solely on partnership firms to maintain a manageable research scope.

## 1.8 Limitation of the Study

The study faced limitations due to its focus on selected partnership audit firms in Addis Ababa which restricts the generalizability of findings to the broader Ethiopian audit sector particularly sole proprietorship firms. Time, resource constraints and respondent willingness further limited the inclusion of all audit firms across Ethiopia potentially overlooking regional variations in audit practices and their impact on investor confidence. The study's reliance on a cross-sectional research design collecting data at a single point in time restricts the ability to analyze changes in investor confidence or audit practices over time.

The study focus on only four variables audit independency, audit transparency, audit firm reputation and financial reporting quality excludes other potential determinates of investor confidences such as regulatory adherence or technological adoption in auditing this constraints affect the comprehensiveness of the research findings.

## 1.9 Operational Definition of the Study

**Investor Confidence:** This is referring to the degree of trust and assurance that investors possess regarding the financial statements and overall financial reporting practices of company in Ethiopia. This is assessed based on investor perceptions regarding the accuracy, transparency and reliability of the financial information provided by companies, particularly those subjected to external audits.

**External Auditors:** This defined as independent third-party professionals or audit firms, registered and licensed by AABE, tasked with the examination and verification of the accuracy of financial statements produced by company. They evaluate whether financial statements comply with established accounting standards and present a true and fair view of a company's financial position.

**Audit Independence:** This signifies the extent to which external auditors remain free from any affiliation or influences that could compromise their Judgement or objectivity during the audit process. An independent auditor ought to possess no financial or personal stakes in the entity being audited, thereby ensuring the objectivity of their work. This study evaluates

Audit independency through the assessment of stakeholders' perceptions regarding auditor's neutrality and their capacity to deliver an impartial audit opinion.

**Audit Transparency:** This covers the clarity and openness with which auditors reveal their findings, methodologies, and potential issues identified throughout the audit process. A transparent audit process provides investors with comprehensive insights, including any limitations or concerns raised by the auditors. This will be appraised based on the clarity with which audit reports communication of essential financial information and the completeness of disclosures relevant to audit methodologies.

**Audit firm reputation:** This denotes the perceived credibility and reliability of audit firms engaged in conducting external audits. Within the scope of this study, reputation will be measured based on investors' perceptions of the audit firm's credibility in performing the audit and its overall positioning within the Ethiopian Market.

**The Financial reporting Quality:** This concerns the measure to which financial statements accurately illustrate the financial well-being and operational effectiveness of a business, excluding inaccuracies, fraud, or omissions. In this study it is evaluated through the analysis of investor perceptions regarding the extent to which the audited financial statement accurately shows the genuine financial standing of the company.

### **1.10 Organization of the Study**

The research report is structured into five distinct Chapters. Chapter one covers the background of the research, statement of the problem, the formulation of key research questions, the study's objective, the hypotheses that guide the research, significance of the study, the Scope of the study, operational definitions of important terms, limitations of study, and the main organization of the entire research.

The second chapter comprises a comprehensive review of relevant literature. In this chapter, both theoretical frameworks and empirical foundations of the study are presented.

The research methodology is thoroughly detailed in the third Chapter, which encompasses the study approach, design, Types and sources of data, the identification of the target population along

with the sample size, sampling methods, and data collection techniques, measurement of constructs, strategies for data analysis and ethical consideration.

In Chapter four the data collected through surveys will be analyzed using appropriate statistical methods. A detailed discussion and presentation of the study's results will be provided in relation to the research questions and hypotheses. Chapter five discuss the summary of findings is derived from chapter four in the context of the literature reviewed in chapter two and provide an in-depth discussion of how external auditors influence investor confidence. Finally, it will provide recommendations for improving audit practice in to enhance investor confidence as well as offer suggestions for future study in this area.

## **CHAPTER TWO**

### **RELATED LITERATURE REVIEW**

#### **2. Introduction**

The literature review offers a comprehensive examination of the current studies and theories related to the role of external auditors in enhancing investor confidence by analyzing prior research both the theoretical foundation and empirical evidence supporting the study objectives identifying critical areas that influence investor confidence.

This chapter is organized into four key sections review of theoretical literature discusses fundamental theories applicable to the role of external auditing, the empirical literature review presents prior research results underscoring both global and Ethiopian study that examine the relationship between external audit role and investor confidence, the conceptual framework of the study a model that explains how independent variables affect the dependent variables and finally the conclusion and knowledge gap section summarizes critical understandings and identifies gaps in the existing literature emphasizing the need for additional research in this study context.

#### **2.1 Theoretical Literature Review**

##### **2.1.1 The Role of External Auditors in Enhancing Investor Confidence**

External auditors' serve as independent third parties tasked with evaluating the accuracy and dependability of financial statements. Their activities provide assurance to stakeholders that corporations are conforming to accounting standards and ethical practices in so doing mitigating information asymmetry that exists between management and investors.

### **2.1.1.1 Enhancing transparency in Financial Reporting**

The necessity for transparency in financial reporting is essential for building investor confidence and external auditors playing a fundamental role in assuring it. Through the independent appraisal of financial records auditors extend assurance that the financial statements of companies accurately show their genuine financial condition. This assurance creates trust among stakeholders including investors creditors and regulators by verifying that financial disclosures are following accounting standards and external auditors facilitating the bridging of the information gap between management and external stakeholders. Ray (2012) stresses that transparent audits mitigate the risks associated with financial misstatements giving investors' confidence in the organization's financial integrity.

External audit assumes a vital function in promoting transparency and accountability which are essential components for developing trust among various stakeholders. Auditors support the legitimacy of government institutions and technical mechanisms, thereby enhancing public trust and investor confidence within the larger economic framework Guillán Montero and Le Blanc (2019).

External auditors play a significant role in enhancing investor confidence by delivering an independent evaluation of organization's financial statements. As expressed by Adeleye (2022), the audit report functions as an essential instrument for mitigating information asymmetry, thereby providing stakeholders with assurance regarding the accuracy and dependability of financial reports. This is particularly important in markets characterized emerging regulatory supervision and evolving governance frameworks.

External auditors deliver assurance concerning the correctness and clarity of financial statements and facilitating informed decision-making by investors. As stated by Vlaović Begović, Tomašević, and Momčilović (2022), external audits evaluate the validity of the going concern assumption, which has direct implication for stakeholders' trust in a corporation's capability to continue in its operations in the foreseeable future. In developing economy in where financial systems remain in a development phase, the function of external auditors in evaluating the going concern assumption becomes increasingly important.

### **2.1.1.2 Strengthening Accountability and Governance**

According to Ray (2012) accountability constitutes a fundamental principle of corporate governance and external auditors reinforce this principle by securitizing management compliance with ethical and regulatory standards. Their independent oversight guarantees that companies uphold appropriate internal control and risk management practices by detecting discrepancies and offering actionable recommendations auditors assist organizations in enhancing their operational efficiency and compliances. In where, regulatory frameworks are still in the process of development external auditors hold an essential position in strengthening governance structure. They function as watchdogs ensuring that corporate activities are aligned with stakeholder interest and legal requirements and enhancing investor confidence in the systems.

External auditors make substantial contributions to corporate governance by serving as independent monitors of financial activities. Their efforts ensure that management adheres to ethical guidelines and regulatory requirements. Ray (2012) articulates that auditors also give recommendations to improve internal control which strengthen the overall governance framework of the organization. Effective audits create a culture of accountability ensuring that organizations align their practices with the expectations of stakeholders.

A fundamental role of external auditors is to address the principal agent problem intrinsic to corporate structures. Managers acting as agent may prioritize personal interests over those of shareholders, the principals. Ojo (2009) emphasizes that external auditors' functions as intermediaries ensuring that financial statements accurately reflect the company's true economic status by deterring practices such as creative accounting, they protect shareholders value and maintain market confidence. Furthermore, external auditors play a crucial role in monitoring management performance by verifying adherence to corporate governance codes. External auditors' function is particularly critical in developing market where regulatory oversight is still evolving and investor protection mechanisms are in the development phase.

### **2.1.1.3 Mitigating Fraud and Financial Risks**

External auditors serve as a crucial defense against fraudulent activities and financial mismanagement by precisely examining a company's financial process and systems. Their specialization knowledge equips them to identify discrepancies and evaluate potential risks that may jeopardize the reliability of financial statements. In developing market where, limited resources and insufficient regulatory oversight frequent increase risks external auditors are essential in ensuring that financial statements are lacking of material misstatement. Their efforts not only alleviate risks but also strengthen market confidence thus facilitating investment inflows El-Faki (2013).

Fraud detection constitutes fundamental component of the responsibilities undertaken by external auditors. Abdi (2017) highlights that auditors deploy rigorous analytical methodologies and risk assessments to identify potential irregularities

External auditors fulfill a vital function in the detection of fraud by assessing internal controls and recognizing risk factors that could result in financial misstatements. El-Faki (2013) underscores the necessity for auditors to adopt a critical approach to evaluating fraud risk referred to as "professional Skepticism" This Methodology encompasses an examination of management practices, industry conditions and operational characteristics to identify potential weaknesses within financial reporting systems by strengthening internal control and enhancing fraud detection capabilities auditors reinforce corporate accountability and boost investor confidence El-Faki (2013).

External auditors increase the credibility of financial information by ensuring its adherence to international auditing standards and legislative requirements. Abdi (2017) articulate that independently conducted audits function as a safeguard against financial misrepresentation and fraud.

## **2.1.2 Underpinning Theories Relevant to Auditing**

### **2.1.2.1 Agency Theory and Its Relevance to Auditing**

Agency theory articulates and conceptualizes the relationship between shareholders (principals) and management (agents) as a contractual framework where managers are delegated with the responsibility of administering the organization to fulfill shareholder aspirations. However, this delegation frequently causes conflicts as managers may prioritize their personal advantage over the interest of shareholders. Examples include unnecessary expenditure on luxuries such as expensive offices and vehicles which escalate organizational expenditures and erode shareholder value. These actions further incorporate the formation of contractual inefficiencies in the decision-making process and expenses associated with monitoring and managers may engage in earnings manipulation to achieve performance benchmarks and secure bonuses thereby exacerbating the information asymmetry between themselves and Shareholders Ang & Cole (1993).

This unrestricted control over expenses has the potential to undermine the accuracy and dependability of reported earnings and financial statements. Leuz et al. (2003) asserts that such conduct ultimately influences the financial performance of the organization. External auditors play a crucial role in mitigating these concerns by enhancing the credibility of financial reporting and ensuring that reported earnings accurately reflect the organization's true financial status.

One of the fundamental functions of external auditors is to address the principal-agent problem inherent in corporate frameworks. Managers in their capacity as agents may pursue personal interests that diverge from those of shareholders. Ojo (2009) underscores that external auditors fulfill the role of mediators guaranteeing that financial statements accurately represent the company's true economic standing by discouraging practices such as creative accounting, they protect shareholder value and reinforce market confidence.

The independence of external auditors is vital in mitigating the principal-agent conflict through the provision of impartial assessment of financial documents, auditors guarantee that the actions undertaken by management are in congruence with the interest of shareholders. As expressed by

Ionescu (2017), the obligations of auditors involve the identification of material misstatements and the verifying compliance with international accounting standards thereby diminishing the probability of management deception. This alignment builds investor confidence by confirming the trustworthiness of financial disclosures.

### **2.1.2.2 Stakeholder Theory and the Importance of trust in Financial Reporting.**

Stakeholder theory explain the relationship between organization and their external environment stressing that a varied range of individual and entities collectively termed stakeholders can influence or be influenced by an organization's operations. Individuals involved include not only those who directly engage like shareholders, employees, investors, customers and suppliers but also other indirectly linked such as government bodies and community at large. This perspective expands accountability beyond the boundaries of shareholders to include all parties with an interest in the organization. Accordingly, businesses are necessitated to consider a variety of social environmental and ethical factors in managing their relationships with stakeholders aligning with an expanded view of corporate responsibility Freeman (1984) and Donaldson & Preston (1995).

External auditors play a critical role in stakeholder engagement by offering independent assurance that organizations practices are in alignment with stakeholder anticipations. Nugroho and Permata (2023) assert that external auditors prove compliance with environmental, social and governance (ESG) criteria which are increasingly emphasized by stakeholders. This validation enhances organizational credibility and reassures stakeholders regarding the company dedications to sustainability and ethical conduct.

Stakeholder theory is basically linked to earnings management and external auditing highlighting the significance of high-quality audits in safeguarding the interest of all stakeholders. Research indicates that management may manipulate financial outcomes to serve their personal interests at the detriment of shareholders and another stakeholder. However external audits operate as effective monitoring instruments that enhance earnings quality and mitigate the risk of earnings manipulation Hodge (2006); Mattingly, Steven and Olsen (2009). Baker and Owsen (2002) further assert that the role of external auditors exceeds the mere benefit of shareholders serving to protect the broader interest of all stakeholders by ensuring financial integrity and transparency.

In the scope of sustainable development goals (SDG) auditors facilitate multi-stakeholder engagement by delivering transparent and actionable insights into an organization's advancement. As noted by Guillán Montero and Le Blanc (2019) auditors enhance stakeholder trust by confirming compliance with regulatory and ethical standards particularly in the sustainable development reporting. This validation strengthens accountability systems and promotes alignment between organizational practices and stakeholder interests.

### **2.1.3 Determinants of Investor Confidence**

#### **2.1.3.1 Audit Independence**

Audit independence denotes the capacity of auditors to execute their responsibility with objectivity, neutrality and autonomy from inappropriate influences. It guarantees that auditors are able to render impartial evaluations regarding an organization's financial statements from lacking conflicts of interest or external Pressure. Audit quality fundamentally relies on auditor independence which ensures that they can perform unbiased and fair assessments of financial records.

The independence of auditors is a basis of effective financial reporting and a critical determinant of investor Confidence. Independence guarantees impartiality and diminishes the potential for inappropriate influence, consequently enabling auditors to render impartial validation of financial statements. Masyitah, Kesuma and Muda (2023) argue that independence is essential for the reliability of audit outcomes and maintaining public trust in financial markets. Independence, as defined by the Institute of Internal Auditors (IIA) encompasses freedom from threats to objectivity enabling auditors to resist pressures from Clients Masyitah et al., (2023).

Deyganto (2021) emphasizes that independence is fundamental to the integrity of Financial disclosures, which constitutes the cornerstone of investor confidence. Independence empowers auditors to exercise their professional judgement free of conflicts of interest, consequently increasing the dependability of their findings.

Independent auditing is critical in developing trust and ensuring the dependability of financial information which serves as a fundamental component in the decision-making processes of

investors. Karkacier and Ertas (2017) emphasize that institutional investor's places significant reliance on independent audit reports when assessing investment projects & independent audit mitigate information asymmetry enhance corporate governance and promote market Efficiency.

#### **2.1.3.1.1 Dimensions of Audit Independence**

Audit independence consists of two principal dimensions independence in fact (the auditor's genuine mindset) and independence in appearance (the perception of objectivity held by external stakeholders) as stated by Church et al., (2018). According to ACCA (2016) dimensions of Audit Independence is stated and classified as follows: -

**Independence of mind:** Refers the mental state that enables the issuance of an opinion without being affected by influences that could compromise judgement thereby allowing an individual to operate with integrity and apply objectivity and professional skepticism.

**Independence in appearance.** The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, possessing knowledge of all appropriate information, including applied safeguards, would reasonably conclude that the integrity, objectivity or professional skepticism of a firm or a number of the assurance team had been undermined.

**Professional skepticism.** An attitude characterized by a questioning mindset watchfulness towards conditions that may indicate potential misstatements resulting from error or fraud and a critical assessment of audit evidence.

#### **2.1.3.1.2 Threats to Audit Independence**

In Ethiopia and similar developing markets, a variety of challenges hinder auditor independence. Guillán Montero and Le Blanc (2019) highlight that insufficient regulatory oversight and limited enforcement of ethical standards render auditors vulnerable to conflicts of interest. In addition, the diminutive audit market in Ethiopia heightens auditors' economic dependence on a small number of substantial clients which further jeopardizes their objectivity. Political influences and inadequate resources also exacerbate this dilemma diminishing the efficacy of audits in enhancing investor confidence.

Audit independence is of dominant for the enabling of impartial and objective evaluations of financial statements. It allows auditors to uphold professional skepticism and deliver assurances that enhance investor trust. In spite of this the independence of financial audit is frequently threatened by several factors, decreasing the standard of audits and shaking confidence in financial statements.

According to ACCA (2016) Key Threats to audit independence that may arise from conflict of interest, Financial dependency and familiarity with the clients are classified as below:

**Self-Interest Threats.** A threat occurs when an auditor possesses a financial or personal interest in the audit organization. This may involve dependence on substantial client fees or business relationships that could compromise objectivity. A high reliance on a singular client particularly within smaller firms increases the likelihood of auditors being inappropriately influenced thereby compromising their independence.

**Self-Review Threats:** These threats happen when auditors are obligated to evaluate their own work such as assessing financial systems they have previously designed. Such as, the provision of non-audit services (NAS) to audit clients can lead to a conflict of interest as auditors may show reluctance to criticize their prior work then undermining the audit's credibility.

**Familiarity Threats:** Which arise when an auditor become excessively aligned with the client often as a result of long-term relationships that extended auditor-client associations may diminish professional skepticism as auditors could develop a bias toward the client affecting the integrity of the audit.

**Intimidation Threats:** This threat emerges when auditors encounter undue pressure from clients such as threats of contract termination or reputational damage that such pressure may oblige auditors to compromise their independence in order to reserve business particularity in markets characterized by high client concentration. Intimidation threats also arises in certain situations where the audit company in a situation of taking the client's part in a dispute or somehow acting as their advocate.

Audit independence remains a complex and dynamic issue that is crucial for sustaining investor confidence. Threats including self-interest, familiarity and regulatory challenges reduce

independence both in fact and in appearance. Church et al. (2018) propose that enhancing audit committee oversight and increasing transparency may effectively mitigate independency threats.

Audit independency is critical for ensuring objectivity and impartial evaluation of financial statements free from conflict of interest. ACCA (2016) defines independency as encompassing both independence of mind (an auditor's unbiased mental state) and independent in appearance (perceived objectivity by stakeholders). Deyganto (2021) emphasizes that independence underpins the integrity of financial disclosure a key factor in building investor confidence. Independent auditors exercise professional skepticism reducing the risk of material misstatements and enhancing the credibility of financial reports El-Faki (2013). Independent auditors address principal-agent conflicts by ensuring financial statements reflect the company's true economic status thereby increase investor trust Ojo (2009). Independent auditors provide unbiased financial statement evaluations reducing agency conflicts and enhancing the credibility of financial disclosures which increase investor trust Ojo (2009). Based on the reviewed literature the researcher has developed the following hypotheses to be tested in this study.

- H1: Auditor independence positively influences investor confidence.

### **2.1.3.2 Audit Transparency**

Audit transparent pertains to the degree to which auditors furnish stakeholders with lucid pertinent and exhaustive information regarding the auditing process and its outcomes. This concept encompasses disclosures pertaining to audit methodology's, principal risks notable findings and professional judgments exercised by auditors. The important of transparency as a fundamental element of audit quality is underscored by its capacity to enable stakeholders particularly investors to comprehend the foundation for audit opinions and reliability of financial statements. As highlighted by ACCA (2016) audit transparency not only cultivates trust but also promotes accountability particularly in markets where the frameworks of corporate governance are still in nascent stage.

Transparent audit processes are instrumental in mitigating information asymmetry that exists between corporate management and external stakeholders. For investor comprehensive disclosure regarding Key Audit Matters (KAMs) such as material misstatements, deficiencies in internal

controls or financial risks offer valuable insights into the governance and health of an organization. ACCA (2016) posits that audit transparency augments the decision-making process by guaranteeing that stakeholders have access to pertinent and intelligible information. Furthermore, transparency bolsters public trust in the integrity of financial reporting an essential factor for ensuring market stability and facilitating investment flows.

Audit transparency also functions as a mechanism for the accountability of both auditors and corporate management. By elucidating the application of audit procedures and the justification for critical judgement auditors exemplify professionalism and compliance with established standards. Audit transparency is fundamentally important for augmenting confidence by ensuring that audits are executed and reported in coherent, consistent and reliable manner. It serves to bridge the information divide among auditors, management and investors thereby enhance trust in financial statements. Chen et al. (2014) assert that augmented transparency elevates the information value of audit reports facilitating informed decision-making for investor and enhancing market efficiency.

Transparent audits afford investors a more nuanced understanding of the reliability of financial statements and the associated key risks. By articulating Chen et al. (2014) precise audit opinions transparency enhances the decision usefulness of financial reports, thereby enabling investors to more effectively evaluate the fundamentals of a firm and it alleviates information asymmetry by revealing Critical Audit Matters (CAMs) and other vital information thus fostering trust and confidence among stakeholders. In developing markets where investors may heavily depend on audit reports due to the scarcity of public financial data transparency assumes a crucial role in cultivating market confidence.

Audit transparency enhances accountability by rendering auditors' activity more perceptible to stakeholders especially investors. As stated by the PCAOB incorporating the engagement partner's name into audit reports serves to enhance both accountability and transparency Cole (2014). This initiative enables investors to assess the qualifications and historical performance of the engagement partner which is essential for evaluating audit quality and increased transparency enhance informed decision-making by mitigating information asymmetry and indicating the integrity of financial reporting.

As stated by Cole (2014). Transparency is in concordance with global best practices as demonstrated by analogous initiatives within the European Union which requires the inclusion of engagement partners' signatures in audit reports. This regulatory framework incentivizes firms to emphasize audit quality and to invest in the professional development of audit partners ultimately serving the interest of investors.

Transparency in external audits acts as a conduit for bridging the information divide between institutions and stakeholders by unveiling critical findings and enhancing clarity regarding financial issues. Guillán Montero and Le Blanc (2019) assert that transparency permits governmental and private entities to synchronize financial practices with global standards thereby fostering credibility among investors. In developing economies transparency not only augments public trust but also establishes the groundwork for sustainable investment climates and transparency fortifies institutional accountability by promoting adherence to rigorous governance practices. According to Guillán Montero and Le Blanc (2019) audit findings frequently uncover inefficiencies, policy inconsistencies and risk that necessitate attention which are vital for the informed decision-making of investors and other stakeholders.

Audit transparency encompasses the provision of insightful, lucid and entity-specific information pertaining to the audit process, significant risks and auditors' judgements. Zhang (2019) elucidates that augmented transparency cultivates investor confidence by addressing the deficiencies of traditional binary audit reports which have been frequently critiqued for their limited information worth. Enhanced audit reports (EARs) implemented globally necessitate that auditors disclose key audit matters (KAMs) and material misstatement risks in a customized non-standardized format. This innovation has transformed the perception of audit quality underscoring transparency as a pivotal driver of financial statement reliability.

Pasquier et al. (2016) Audit transparency promotes compliance with international standards and regulations by revealing critical information concerning audit processes and findings align their methodologies with best global practices thereby amplifying the credibility of financial reporting and further assert that transparency facilitates the identification of deficiencies within internal control systems which holds particular significance for markets where regulatory frameworks are still in a state of evolution.

Audit transparency involves the clear and comprehensive disclosure of audit methodologies, key audit matters (KAMs) and significant risks enabling stakeholders to understand the basis of audit opinions. ACCA (2016) suggests that transparency reduces information asymmetry enhancing the decision-usefulness of financial statements. Chen et al. (2014) argue that transparent audit reports provide investors with insights into financial risks increasing confidence in audited financial statements.

Zhang (2019) notes that Enhanced Audit Reports (EARs) improve perception of audit quality by addressing the limitations of audit reports escaping important information. Guillán Montero and Le Blanc (2019) emphasize that transparency aligns financial practices with international standards enhance credibility. Stakeholders theory reinforces this as transparent audit meets the expectations of investor and other stakeholders by promoting accountability and trust Freeman (1984); Pasquier, Evers, Han & Bacon (2016).

Transparent audit reports including KAMs reduce information asymmetry and provide insights into financial risks aligning with stakeholder expectations and enhancing investor trust ACCA (2016). Based on the reviewed literature the researcher has developed the following hypotheses to be tested in this study.

- H2: Higher transparency in audit reporting increases investor confidence in Financial Statements

### **2.1.3.3 Audit Firm Reputation**

Audit firm reputation denotes the perceived credibility, dependability and integrity of an auditing entity which is assessed based on its historical performance, operational efficacy and commitment to professional and ethical standards. Valued firms are frequently acknowledged their ability to deliver audits of superior quality attributable to their extensive resources, specialization expertise and dedication to preserving their position in the marketplace. The reputation of an audit firm serves as an indicator of audit quality to stakeholders that increased trust in the financial statements that have been subjected to audit examination Sabti and Anssari (2022).

Audit firm reputation is integral to enhancing investor confidence by signaling both audit quality and reliability. As expressed by Aronmwan et al. (2013) firms with strong reputations have greater

incentives to produce high quality audits due to their economic rent and public image. Promoting audit firm reputation through regulatory support and capacity enhancement can substantially improve the credibility of financial statements and develop trust within the growing financial landscape.

Reputation significantly impacts audit quality by ensuring that firm consistently comply with professional and ethical standards. Yates and Song (2003) state that clients audited by firms of high repute experience less adverse market reactions during critical events such as seasoned equity offerings in contrast clients audited by firms with less reputations. This observation suggests that the market perceives the financial statements audited by reputable firms as possessing greater reliability.

The function of auditors in confirming documents goes beyond compliance, as they provide support to businesses in managing the risks linked to financial errors. Firms with reputations are less inclined to compromise their standards given that their long-term sustainability is contingent upon maintaining stakeholder trust. This trust assumes particular significance during pivotal financial events such as initial public offerings or seasoned equity offering where credibility is utmost importance Yates & Song, (2003).

Firms with high reputations are driven to deliver exceptional audit quality in order to sustain market trust. Corona and Randhawa (2010) argue that reputable firms are more motivated to disclose detected fraud during one-off engagements as their credibility is closely linked to accurate and impartial reporting and strong reputations empower audit firm to charge premium fees thus enhancing their motivational to provide quality service.

Reputational functions as a key indicator of an audit firm's competence and dependability prominent and established entities commonly designated are perceived as credible owing to their extensive resources and proficiency in administering complex engagements Sabti & Anssari, (2022). Firm with high reputational standing implement stringent quality control measures and allocate resources towards training thereby ensuring that audits confirm to professional standards. This reputation facilitates client retention the obtaining of premium fees and the preservation of public confidence in the integrity of financial reporting. Firms possessing strong reputations exhibit a lower tendency to issue misleading audit reports as any such compromise could result

significant reputational harm and legal consequences. Sabti and Anssari (2022) emphasize that the accuracy of continuity opinions rendered by reputable auditors is markedly superior thus building confidence among stakeholders. Additionally, these firms demonstrate a greater willingness to embrace innovative auditing technologies which further increases the quality of their service offering.

Audit firm reputation reflects the perceived credibility, reliability and ethical standing of audit firm based on its track record and adherence to professional standards. Aronmwan, Ashafoke & Mgbame (2013) argue that reputable firms are incentivized to deliver high-quality audits to maintain their fee and public image and enhancing investor trust. Yates and Song (2003) find that Financial statements audited by reputable firms prompt less adverse market reactions during critical events signaling reliability to investors.

Sabti and Anssari (2022) highlight that reputable firms implement rigorous quality controls and invest in training reducing the risk of misleading audit reports. According to Fan and Wong (2001) reputable auditors act as effective monitors of management reducing agency conflicts. Stakeholder theory further states that a reputable firms address stakeholder expectations through high-quality audits Freeman (1984).

Reputable audit firms signal high-quality audits reducing adverse market reactions and enhancing investor trust in financial statement reliability Aronmwan et al., (2013). Based on the reviewed literature the researcher has developed the following hypotheses to be tested in this study.

- H3: The reputation of the audit firm positively influences investor confidence in the reliability of financial statements.

#### **2.1.3.4 Financial Reporting Quality**

Financial reporting quality concerns the degree to which financial statements offer exact, applicable, trustworthy and clear data concerning an organization's financial results and situation. The delivery of high-quality financial reporting guarantees that the information disclosed is lacking of material misstatements accurately reflects the economic reality and serves as a valuable resource for decision-making by stakeholders such as investors, creditors and regulatory bodies.

Sitota (2021) underscores that superior financial reporting diminishes information asymmetry, promotes market transparency and bolsters investor confidence.

Salah (2021) accentuates that Financial reporting quality is principal for decision-making processes particularly in investment and resource allocation. Typical financial reporting motivates trust mitigates information asymmetry and enhance market efficiency. In contexts where financial markets are developing the enhancement of Financial reporting quality through external auditing is crucial for attractive both domestic and international investment.

Financial reporting quality guarantees that financial statements are relevant, reliable and indicative of a company's faithful financial status which is essential for developing investor trust. Rashid, Wan Daud, Zainol, Salleh, Yazid, Endut, & Ghazali, (2018) emphasize that the adoption of high-quality financial reporting standards IFRS increases transparency and raises accountability both of which are vital for reassuring shareholder confidence. In Ethiopia the alignment with global best practice through the adoption of IFRS via proclamation No. 847/2014 has substantially enhanced the framework for the preparation of financial statements.

The objectivity, technical proficiency and professional diligence of the internal audit team were determined to significantly enhance the quality of financial reporting when effectively integrated with external audits. As Al-Sabti (2023) points out strong internal auditing strengthen internal controls ensure adherence to regulations and mitigate the risks associated with financial statements. Enhanced capability in financial reporting thus building investor trust. The research conducted by Azzama, Alrabbaa, AlQudah, & Mansur(2020) explains the beneficial effects of collaboration between internal and external auditors on Financial reporting quality and the international standards on auditing (ISA) framework facilitates this collaboration allowing external auditors to depend on internal audits which improves the timeliness and accuracy of reporting.

Al-Sabti (2023) notes that the integration of advanced technologies such as big data and cloud computing has improved the accuracy and efficiency of financial reporting processes. The digital transformation empowers auditors to scrutinize extensive datasets thereby reducing errors and enhancing the quality of financial reports.

According to Qader and Cek (2023) external auditors fulfill a pivotal function in enhancing financial reporting through the verification of the accuracy and completeness of financial

statement. These audits additionally act as a mechanism for the detection and management of financial risks which is essential for the sustainability of organizations and the independency and autonomy of external auditors substantially affect financial reporting quality. Independent auditors are more proficiently positioned to deliver objective evaluations thus enhancing the credibility of financial statements Qader & Cek (2023).

High financial reporting quality is characterized by compliance with attributes such as relevance, Faithful representation, timeliness and comparability. Uyen (2020) underscores that the size and capacity of auditing firms exert a significant influence on financial reporting quality. Larger firms prepared with established quality control procedures and experienced auditors are more inclined to produce reliable financial reports. Internal mechanisms such as periodic reviews, compliance with auditing standards and comprehensive training enhance the consistency and accuracy of reporting. Furthermore, the degree of specialization exhibited by auditors significantly strengthens their capacity to identify irregularities and uphold adherence to financial status. Auditors possessing skill in particular sectors facilitate more accurate assessments of financial information and mitigating inaccuracies and building confidence among stakeholders Uyen (2020).

Financial reporting quality refers to the accuracy, reliability and compliance of financial statements with applicable standards ensuring they are free from material misstatements. Salah (2021) underscores that high-quality financial reporting is essential for investor trust as it accurately reflects a company's financial health. Chen et al. (2014) argue that quality financial reports reduce information asymmetry enabling confident investment decisions. Karkacier and Ertaş (2017) note that institutional investors rely on audit financial statements adhering to standards to assess risk and profitability. Agency theory support this as quality reporting verified by auditors mitigates earnings manipulation protecting shareholders interest Leuz, Nanda & Wysocki (2003). Stakeholder theory reinforces that quality reporting meets the needs of investors and other stakeholders to developing trust Baker & Owsen (2002).

High-quality financial reporting compliant with applicable standards and free from misstatements provide reliable information reducing information asymmetry and increasing investor trust Chen et al., (2014) and Leuz et al., (2003). Based on the reviewed literature the researcher has developed the following hypotheses to be tested in this study.

- H4: The quality of financial reporting increases investor confidence in Financial Statements.

## **2.2 Empirical Literature Review on The Role of External Auditors.**

### **2.2.1 Impact on Financial reporting and Market response**

The empirical evidence indicates that external auditors play a key role in safeguarding reliability and transparency of financial statements. Wang et al. (2024) discover that sudden last-minute change to signing auditors adversely influence stock prices signifying investor skepticism regarding the integrity of financial disclosures. In particular alternation made at late-stages create doubt surrounding audit methodology and increase concerns regarding the completeness and accuracy of financial reports. Additionally, the investigation points out that investors see repeated auditor changes or late appointments as possible alerts which could indicate managerial interfering or inadequacies in the audit process Wang et al., (2024). This observation stresses the significance of stable auditor-client relationships in maintaining investor trust.

### **2.2.2 The Impact of Independence on Financial Statement Credibility**

Independent external auditors provide unbiased assurance enhancing the credibility of financial statements. Yao, Yusheng & Bah (2017) emphasize that auditor independence alleviates conflict of interest ensuring that financial reports faithfully represent a company's economic condition and the empirical investigation illustrates a positive correlation between auditor independence and the dependability of financial information especially when auditors comply with professional standards. However, the analysis identifies challenges such as client pressure and threats of familiarity which may compromise independence.

### **2.2.3 Enhancing Corporate Governance Through Audits.**

External auditors are essential to corporate governance frameworks ensuring that managerial actions align with the interests of shareholders. Newman et al. (2003) demonstrate that jurisdictions characterized by strong auditor accountability and legal structures exhibit higher

levels of investor confidence. The study further identifies that Legal penalties and reputational concerns encourage auditors to keeping high professional standards thus enhancing their credibility as agents of corporate governance Newman et al., (2003). This is associated with increased ownership dispersion and enhanced equity Valuations.

External auditors play a vital role in strengthening corporate governance by ensuring the accuracy and transparency of financial reports. Jaber (2023) observes that the independent evaluations conducted by auditor's enhance stakeholder trust and promote accountability within organizations by identifying deficiencies in internal controls and suggesting remedial measures external auditors facilitate the alignment of management practices with regulatory and ethical norms. Furthermore, the study explains that corruption scandals frequently expose inadequacies within governance systems. Jaber (2023) points to cases where insufficient responses to audit observation have eroded investor confidence thereby underscoring the necessity for more rigorous governance and oversight mechanisms.

#### **2.2.4 Addressing the expectation Gap**

The empirical evidence underscores a notable divergence between the level of assurance that auditors provide and the expectations held by investors. Geiger (1994) reports that nearly 71% of surveyed investors believe that auditors ought to deliver absolute assurance in detecting fraudulent activities notwithstanding the fact that prevailing professional standards endorse reasonable assurance. This mismatch suggests that investors frequently overestimate the extent of auditor's responsibilities which may result in dissatisfaction when discrepancies or fraudulent activities are uncovered. In order to mitigate this concern, the research suggests enhanced transparency and communication concerning the scope and inherent limitations of audits.

#### **2.2.5 The Impact of auditor Autonomy on Financial reporting**

Qader and Cek (2023) assert that the independency of external auditors significantly enhances the quality of financial accounting information by diminishing errors and biases within reporting. The investigation illustrates a positive correlation between the autonomy granted to auditors and the trustworthiness of financial disclosures with independent auditors showing enhanced capability in

spotting major errors. This enhancement of transparency is critical for the decision-making processes of investors.

Moreover, the research illustrates that increased auditor autonomy empowers auditors to apply professional judgement proficiently thus reducing undue influence from management Qader and Cek (2023). This degree of autonomy is particularly vital for addressing complex financial transactions and identifying fraudulent activities thus safeguarding the interests of stakeholders.

### **2.2.6 Audit Opinions and Investor perception**

Audit reports especially those featuring modified opinions significantly influence investor decisions by indicating potential risks or issues within a company's financial statements. The investigation conducted by Dănescu and Spătăcean (2018) reveals that while unmodified audit opinions are positively correlated with investor confidence and modified opinions frequently lead to mixed reactions. For instance, despite receiving a qualified opinion certain entity observed a favorable movement in trading prices suggesting irrational response from investors. This discrepancy implies that investors may be inclined to depend on alternative factors such as market trends when formulating their decisions Dănescu & Spătăcean (2018). The research underlines the critical need for enhancing investor education regarding the importance of audit opinions.

## **2.3 Conceptual Framework of The Study**

A well-constructed conceptual framework serves as for understanding the relationships among variables in a research investigation. Opong (2013) highlights that such frameworks serve to bridge theoretical constructs with empirical research thus directing the design and analytical processes of the study.

The conceptual framework of this study seeks to establish the relationship between investor confidence (the dependent Variable) four key Independent Variables: Audit Independence, Audit Transparency, Audit Firm Reputation and Financial Reporting Quality. Each of these dimensions captures a critical aspect of audit quality and collectively they provide a complete view for Evaluating the effectiveness of external audits in building trust among stakeholders.

This research aims to assess the extent to which these variables collectively how impact investor confidence and providing insights into the mechanisms through which external auditors enhance the credibility of financial markets. By focusing on selected audit firms and their clients as a case study. The research will explain the typical challenges and opportunities faced by auditors in performing quality of audit, offering a strategic framework for audit practices and governance structures to encourage sustainable investor confidence on external audit practice.

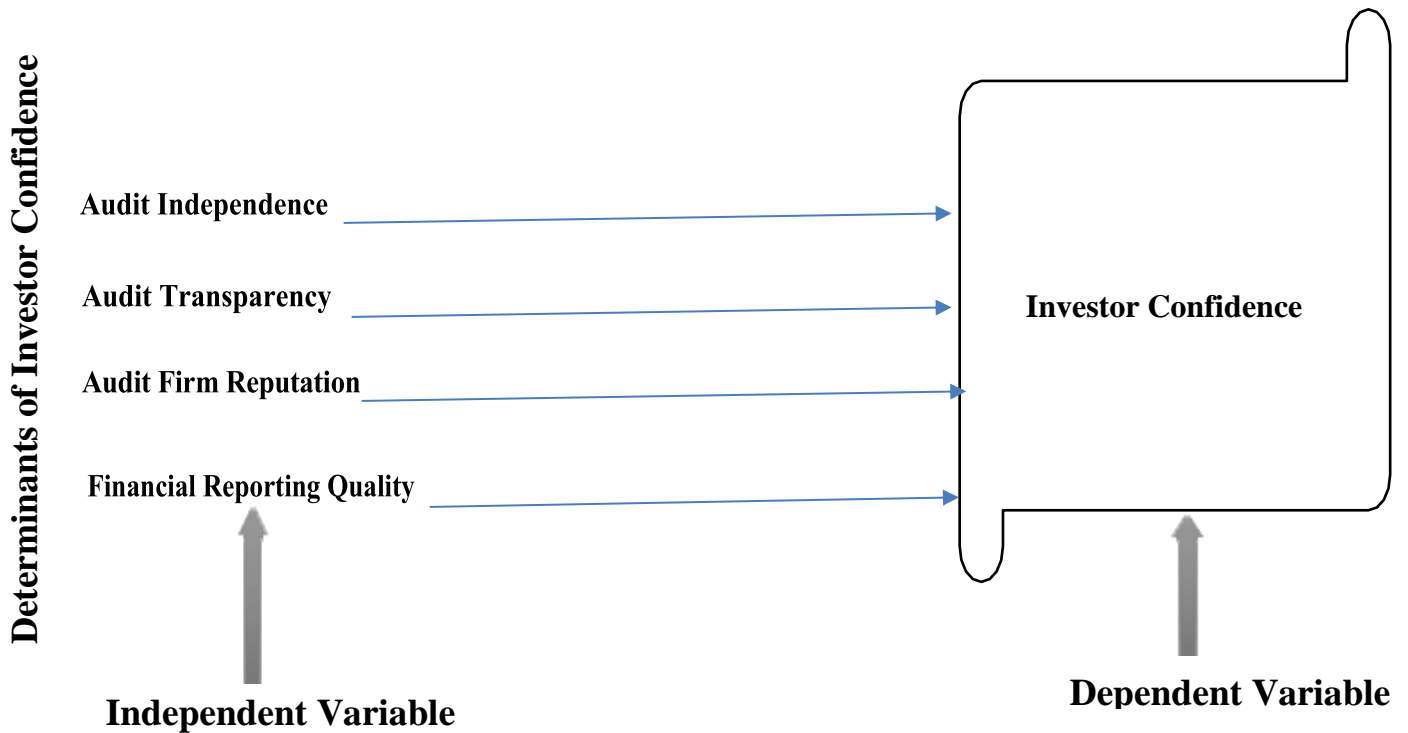


Figure 2.1 Conceptual Frameworks of the Study

## 2.4 Conclusion and Knowledge Gap

External auditors play a vital role in enhancing investor confidence by ensuring transparency, accountability and integrity of financial reporting. The relationship between investor confidence and critical dimensions of audit independency, transparency, audit firm reputation and the financial reporting that stresses the necessity for strong auditing practices. Research shows that independent and competent auditors are skillful at identifying material misstatements thereby build trust among stakeholders. Furthermore, transparent auditing processes and compliance with

regulatory standards reinforce corporate governance and stakeholder trust particularly within developing markets.

Despite the global focus on the significance of audit quality in enhancing investor confidence there exist substantial gaps remain in Ethiopia context concerning the in dependability of audit quality. A lot of researches have been conducted in dependability regarding audit independency and quality however, in areas such as audit transparency, audit firm reputation and the quality of financial reporting remain insufficiently examined in Ethiopia, resulting in the existing literature inadequately examining the influence of these determinants on investor trust and decision-making with in Ethiopia situation. Furthermore, while earlier investigation has addressed the roles and legal liabilities of auditors there is limited research as focused on the alignment of Ethiopian auditors' practices with international ethical standards. Kesto & Bayeh (2021) emphasize that the existing literatures fails to sufficiently analyze how ethical non-compliance impacts on stakeholder trust and decision-making process.

Addressing these issues through research in the area is very useful in giving an insight for both audit firms and investors regarding the factors influencing investor confidence. Such investigations will also assist regulatory and professional bodies in effectively overseeing the external audit profession and maintaining trust among stakeholders. Therefore, it would be worthwhile to examine the audit firms and their clients that the related determinants affecting investor confidence and to propose actionable recommendations aimed at enhancing their influence on investor trust.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY OF THE STUDY**

#### **3. Introduction**

Research methodology constitutes a systematic framework employed to investigate about the methods, procedures and techniques utilized in the collection, analysis and interpretation of data. Accordingly, this chapter covers the research approach, research design, types and sources of data, determination of target populations and sample size, sample techniques, ethical consideration, Methods of data collection and analysis.

#### **3.1 Research Approach**

According to John (2014) research approaches represent the plans and procedures for investigation that include the range from broad assumptions to specific methodologies for data collection, analysis and interpretation. The determination of research methodology centers on the characteristics of the problem being analyzed in addition to the researcher's personal experiences and the audience for the examination. Quantitative survey is utilized to examine the extent of the relationship between independent and dependent variables providing a structured approach to measuring and analyzing these associations. The Primary aim of this study is to evaluate the role of external auditors in enhancing investor confidence. Thus, this research is predominantly conducted utilizing a quantitative research approach to fulfill the study's objective.

#### **3.2 Research Design**

This examination adopts a quantitative research design to discover the relationship between external auditors and investor confidence. A quantitative is selected due to its capacity to systematically measure and analyze numerical data and ensuring an objective evaluation of the relationships among key variables. The design is characterized as both descriptive and explanatory. Explanatory design was conducted to provide for an explanation of cause and effect relationship among comprehensive understanding of the role of external audit quality assessed through factors

such as audit independence, transparency, regulatory compliance, audit firm reputation and financial reporting quality and dependent variable investor confidence.

Using a survey-based methodology structured questionnaire are distributed to a target population to gather primary data. This approach facilitates the quantification of attitudes, perceptions and experiences pertaining to audit practices and their impact on investor confidence.

### **3.3 Units of Analysis**

The units of analysis of this study are the Partnership audit firms and their Clients company in Addis Ababa, encompassing 22 partnership audit firms register with the Accounting and Auditing Board of Ethiopia (AABE) and selected audit firm's client company from different sectors. These units are chosen to investigate the impact of audit independence, audit transparency, audit firm reputation and financial reporting quality on investor confidence which capturing both audit firms' practices and clients' financial reporting.

### **3.4 Data Type and Sources**

The research methodology incorporates both primary and secondary data to give a complete understanding of the function of external auditors in increasing investor confidence. Primary data is acquired directly from external auditors, finance managers and General manager and through precisely structured questionnaires. These tools are constructed to capture quantitative insights into critical variables. The primary data summarizes the direct perceptions and experiences of stakeholders to providing valuable empirical evidence regarding the relationship between the role of external auditor and investor confidence.

Secondary data is sourced from Financial statements, regulatory inspection reports. Key reference consists of Ethiopian legal frameworks such as financial reporting proclamation alongside professional standards established by international auditing organizations. This Secondary information provides a theoretical and contextual foundation for enhancing the empirical data

collected through surveys. By integrating these different data types, the study guarantees a balanced and complete analysis to enhancing the reliability and validity of its conclusions.

### **3.5 Target population and Sample Size Determination**

#### **3.5.1 Target Population**

The target population for this investigation includes private audit firms in Ethiopia that are authorized by the Accounting and Auditing Board of Ethiopia (AABE). Two categories of firms determined by their ownership model: Partnership and Sole proprietorships. There are 22 firms established as partnerships and 200 firms operating as Sole proprietorships making a total of 222 Firms. (Approved by AABE as of January 2025). However, this study concentrates exclusively on partnership firms given their perceived experience and capacity in managing complex audits which is essential for examining their role in enhancing investor confidence. Therefore, the researcher target participants including Senior auditors, Audit managers, Audit directors and partners from Partnership audit firms. Junior auditors are excluded from the study population because their limited professional experience may hinder their ability to accurately assess and understand the influence of independent variables on investor confidence.

The target population from partnership firms includes 47 audit partners, 2 audit directors, 20 audit managers and 43 senior auditors making a total of 112 individuals. From the clients of these audit firms the target population consists of 38 finance managers and 17 general managers totaling 55 participants. Audit firms client participation in this research is essential due to the pivotal role that clients undertake in the audit process which provide financial data, management representations and access to operational information. Finance managers are deeply engaged in the preparation of financial statements and direct communication with auditors throughout the audit engagement. General managers engaged in the technical accounting matters provide strategic insights regarding the overall impact of external audits on organizational governance, regulatory adherence and stakeholders trust. Collectively the viewpoints of client-side managers reinforce the finding that high-quality, independent and transparent audits significantly enhance investor confidence.

### **3.5.2 Sample Size Determination**

Considering the targeted emphasis on partnership firms all 22 firms within this classification are incorporated into the study. All 22 partnership firms senior and above-senior auditor positions are included in the sample rather than using a sampling technique to ensure comprehensive coverage of the populations. This approach is feasible due to the manageable number of audit firms in this category and helps that no critical information from the relevant group is missed.

In addition to audit firms the research includes key client companies audited by these firms selected through purposive sampling. To ensure proportional representation audit firm clients are chosen from various industries and company sizes reflecting the diversity of the audited market. A ratio of 1 to 3 client per audit firm was used to determine a sample size ranging from approximately 22 to 66 client companies. These client firms were selected based on information from the audit firms' engagement logbooks specifically choosing the first three clients with highest turnover as of 30 June 2024 audit engagement.

### **3.6 Sampling Techniques**

The study centers on selected audit firms and their client as the principal population. A non-probability sampling methodology is implemented due to the focused nature of the inquiry. This technique is thought suitable when the aim is to gather specific insights from a distinctly defined group rather than to generalize conclusions to the broader population.

In particular the research employees purposive sampling to elect participants based on their significance and proficiency. Audit firms are selected based on their active participation in auditing entities which has public interest and their ownership model, while clienteles are drawn from organization with considerable investor engagement. This selection process ensures that the respondents can provide informed viewpoints on the manner in which external auditing affects investor confidence.

### 3.7 Methods of Data Collection

This investigation utilizes both primary and secondary data collection methodologies to ensure a comprehensive understanding of the study. Primary data is collected through systematically designed Likert scale questionnaires disseminated to chosen audit firms established through partnerships alongside their principal clients adopted from previous study Feleke (2017), Assefa (2021), Tadesse (2017) and Wudu (2014) . The questionnaires are focused on various dimensions such as audit transparency, independence, audit firm reputation, Financial Reporting Quality and their consequential impact on investor confidence. Furthermore, interviews are executed with selected audit partner to gather in depth auditing practices and investor view.

Secondary data serves to supplement the primary data by suppling contextual perspectives. This includes a thorough examination of annual reports, audited financial statements and relevant inspection report from the Accounting and Auditing Board of Ethiopia (AABE). Regulatory frameworks including the International Standards on Auditing (ISA), International financial reporting (IFRS). The integration of these methodology ensures a comprehensive and detailed understanding of the role of external auditors in enhancing investor confidence.

### 3.8 Methods of Data Analysis

The data collected for this study is analyzed using STATA 14 software due to its sophisticated statistical capabilities to assess the correlation between external auditing practices and investor confidence. Quantitative data obtained from structured questionnaires is precisely cleaned, coded and subsequently inputted into STATA for analytical purposes and the following analysis will be conducted:

- A. Descriptive statistics** encompassing means, frequencies and standard deviations are employed to summarize significant variables and deliver an overview of the dataset.
- B. Correlation Analysis** is performed to investigate the interrelation between external auditing practices and the confidence of investors. This statistical methodology evaluates both the strength and direction of relationships among independent variables audit

independence, transparent, Audit Firm Reputation, Financial Reporting Quality and the dependent variable investor confidence. The correlation coefficient Pearson's (r) is used for variables that are continuous while, Spearman's rank correlation is applied when dealing with ordinal data ensuring responses from Likert scales are treated correctly.

### C. A multiple regression Analysis

The research employed a multiple regression model to discover the factors that affect investor confidence. The independent variables included Audit Independence, Audit Transparency, Audit Firm Reputation and Financial Reporting Quality. Ordinary Least Squares (OLS) with multiple variables was selected for its accuracy in assessing the relationship between the dependent variable (investor confidence) and the identified independent variables.

The model can be expressed as  $Y = F(X_1, X_2, X_3, X_4)$  Where Y represent investor confidence and X1 to X4 represent Audit Independence, Audit Transparency, Audit Firm Reputation and Financial Reporting Quality respectively.

The refined analytical Model,  $IC = \beta_0 + \beta_1 AI + \beta_2 AT + \beta_3 AFR + \beta_4 FRQ + \epsilon$ , introduces the constant  $\beta_0$  which represent investor confidence when all independent variables are zero, and the slope  $\beta_1$  to  $\beta_4$  indicating the change in investor confidence corresponding to a one-unit change in each respective independent variable. The error term,  $\epsilon$  considers unobserved factors that influence investor confidence contributing to a comprehensive understanding of the relationships with the role of external auditors in enhancing investor confidence. Where:

IC= Investor Confidence (**dependent Variable**)

$\beta_0$  = Constant term

$\beta_1, \beta_2, \beta_3, \beta_4$  = Coefficient for each independent Variable.

$\epsilon$  = Error term.

**(Independent Variable)**

**AI** = Audit Independence.

**AT** = Audit Transparency.

**AFR** = Audit Firm Reputation.

**FRQ** = Financial Reporting Quality.

#### **D. Diagnostic tests**

Diagnostic tests inclusive of Reliability, multicollinearity, heteroscedasticity assessments (Breusch-pagan test), Normality and Ramsey RESET test will be performed to validate the strength of the model. The statistical significance is examined at 95% confidence intervals ( $P < 0.05$ ) and regression results are interpreted to determine the relative influence of each variable on investor confidence.

### **3.9 Ethical Consideration**

As suggested by Trochim (2000) and Sekaran (2006) this research adheres to strict ethical standards to safeguard the rights privacy and welfare of participants. All participants are required to give informed consensus before data collection and clearly explaining the purpose of the study and the voluntary nature of participation. Confidentiality is maintained by keeping responses and securely archiving all collected data thereby ensuring that sensitive information remains undetectable to individual participants. The research also aligns with professional and institutional ethical guidelines. Additionally, the research mitigates any potential conflict of interest or bias by maintaining objectivity throughout data collection and analysis. Participants are treated with respect and no undue pressure or force is imposed during their involvement.

## CHAPTER FOUR

### DATA PRESENTATION AND DAT ANALYSIS

#### 4 INTRODUCTIONS

This chapter presents the results in line with the stated research questions and objectives using the research design and methodology outlined. The chapter includes an overview of the response rate and demographic profile of the respondents followed by descriptive statics for the study variables. The chapter also details the results of the regression analysis including diagnostic tests conducted to assess the reliability, validity and suitability of the regression modal. Additionally, it covers the ANOVA results and examines the relationship between the dependent and independent variables based on the sign and degree of the estimated coefficient which were analyzed using STATA version 14.2

##### 4.1 Response Rate

A total of 167 questionnaires were distributed to selected audit firms and their client organizations for data collection. Of these, 148 were properly completed and returned a response rate of approximately 89%. According to Fincham (2008), a 60% response rate is generally acceptable while, a rate above 70% considered very good in most social science research. Therefore, as presented in table 4.1 the 89% response rate achieved in this study is considered good and sufficient to meet the research objective as shown below table 4.1

<b>Description</b>	<b>Total Distribution</b>	<b>Response</b>	<b>Response Rate</b>
Audit firms	112	99	88%
Audit firm Clients	55	49	89%
<b>Total Questionnaires</b>	<b>167</b>	<b>148</b>	<b>89%</b>

Source: Research data (2025)

## 4.2 Reliability Test Result

Reliability refers to the consistency of a measurement tool and its ability to produce results free from random error Zikmund (1997). In this study internal consistency of the five key variables was assessed using Cronbach's Alpha following appropriate reversing coding. A test was conducted on 148 employees from audit firms and their client organizations. The results show a Cronbach's Alpha Value of above 0.70 indicating a high level of internal consistency and confirming that the measurement scales is reliable hair (1992).

Table 4.2

Variables	Number of items	Cronbach's Alpha	Internal consistency
Audit Independence	5	0.760	Acceptable
Audit Transparency	5	0.705	Acceptable
Audit Firm Reputation	4	0.717	Acceptable
Financial Reporting Quality	4	0.754	Acceptable
investor confidence	5	0.708	Acceptable

Source: Research data (2025)

### 4.3 Descriptive Statistics Analysis

#### 4.3.1 Demographic Characteristics of Respondents

Table 4.3

Description		Frequency	Percent
Gender	Male	129	87.16
	Female	19	12.84
	<b>Total</b>	<b>148</b>	<b>100.0</b>
Age	20-30 Years	63	42.57
	30-40 Years	52	35.14
	40-50 Years	30	20.27
	Above 50 Years	3	2.03
	<b>Total</b>	<b>148</b>	<b>100.0</b>
Working Experience	Less than 3 year	42	28.38
	3-5 years	21	14.19
	6-10 years	25	16.89
	More than 10 Years	60	40.54
	<b>Total</b>	<b>148</b>	<b>100.0</b>
Level of Education	BA Degree	41	22.70
	ACCA	56	37.84
	BA Degree; ACCA	7	4.73
	Masters	20	13.51
	Masters; ACCA	24	16.22
	<b>Total</b>	<b>148</b>	<b>100.0</b>
Current Role	Senior auditor	42	28.38
	Audit Manager	13	8.78
	Audit Director	1	0.68
	Partners	43	28.38
	Finance Manager	36	24.32
	General Manager	13	8.78
	<b>Total</b>	<b>148</b>	<b>100.0</b>

Source: Research data (2025)

The demographic analysis of the respondents provides important understandings into the background and competencies of the audit professionals and Client representative engaged in the study. Considering these characteristics is vital for generalizing the reliability and relevance of

their perspectives concerns on the role of external auditors in enhancing investor confidence as shown above table 4.3 the analysis of gender demographic indicates that 87.16% of participants were male in contrast to 12.84 % were female. This observation underscores a few female professionals in the auditing profession in Ethiopia. Nonetheless, both male and female professionals rendered significant contribution to the audit quality and perceptions of investor confidence.

In relation to age demographics the predominant segment of respondents 42.57% fell within the age of 20-30 years followed by 35.14% in the 30-40 years age group. The 20.27% were aged 40-50 years and only 2.03% exceeding the age of 50. This age distribution indicates a relatively young work force within the auditing sector potentially reflecting recent professional training and academic qualification aligned with international standards. Younger professionals generally exhibit greater adaptability to reforms and technological advancements in auditing practices which are pivotal for investor confidence in a developing Ethiopian growing economy.

Concerning professional experience 40.54% of respondents possessed over a decade of professional experience indicating a solid foundation of audit knowledge and practical engagement. This factor is crucial in delivering high-quality audit as experienced auditors are better in to make good judgement, identify material misstatements and ensure adherence to standards elements that are fundamentally linked to investor confidence.

The educational achievement of respondents indicates that 37.84% possessed the ACCA qualification and an additional 16.22% held both a master's degree and ACCA Certification. Combined with 22.70% holding a bachelor's degree and 13.51% possessing a master's this data confirms that a majority of participants have attained advanced academic and professional training. This is consistent with competencies expected of external auditors operating in emerging sectors and demonstrates the profession's ability to fulfill investor expectations through internationally accepted auditing practices.

In terms of current professional role 28.38% of respondents were senior auditors and another 28.38% were served as audit partners. This indicates that over half of the respondents occupied leadership or highly responsible roles within audit engagements. The remainder comprised audit managers 8.78% and an audit director 0.68%. The aggregation of experienced professionals in key

decision-making positions confirm that the sample reflects informed perspectives on audit quality and its impact on investor trust.

In the study 24.32% of the total 148 respondents were finance managers and 8.78 were general managers representing client organizations that engage external auditors. These participants totaling 33.1% of the sample play critical roles in providing financial data and management insights during audits. Their inclusion strengthens the study's findings as their direct interaction with auditors underscores the importance of independence and transparent audits in financial reporting enhancing investor confidence in financial reporting.

#### **4.3.2 Descriptive Statistics Analysis for Audit Independence.**

As shown in below Table 4.4 the variable of audit independence evaluated through five distinct items with a sample of 148 respondents shows mean scores that range from 3.29 to 3.61 and Standard deviation 1.04 to 1.12 on an assumed 5-point Likert scale indicating neutral to slightly positive perceptions regarding the independence of external auditors. The highest mean score 3.61 associated with auditors acting in the best interest of investors suggests stronger confidence in this aspect whereas, the lower mean score 3.29 related to freedom from undue influence and objectivity concerning fees reflects a degree of moderate uncertainty with standard deviations highlighting concerning fees reflect a degree of the presence of varied opinions this concerns surrounding fees and influence may limit trust emphasizing the necessity for improvement in auditing practices.

The moderate variability Standard deviation from 1.04 to 1.12 reflect a diverse of respondent experiences possibly due to inconsistent audit practices within Ethiopia reinforcing the necessity for improvements aimed at strengthening perceptions of independence.

Table 4.4

Items of Audit Independence	N	Mean	SD.
External auditors are free from undue influence from the company they audit.	148	3.290541	1.120334
I believe external auditors act in the best interest of investors even when it conflicts with management desires.	148	3.608108	1.040899
External auditors independently challenge management accounting when needed.	148	3.331081	1.121154
The fees paid to external auditors do not compromise their objectivity.	1148	3.290541	1.120334
External auditors maintain objectivity even in long term relationships with clients	148	3.331081	1.1211

Source: Research data (2025)

#### 4.3.3 Descriptive Statistics Analysis for Audit Transparency

Table 4.5

Items of Audit Transparency	N	Mean	SD.
Audit reports clearly explain the scope of the audit.	148	2.925676	1.149334
Audit reports provide sufficient details about key audit matters and significant risks.	148	3.331081	1.121154
Audit reports are written in a clearly and concisely ensuring financial statement users can easily understand their content and conclusion	148	3.283784	1.100652
Audit reports provide valuable insights into the company's financial performance and internal controls.	1148	2.675676	1.07042
External auditors openly report financial irregularities.	148	2.939189	1.144204

Source: Research data (2025)

As shown in above Table 4.5 the variable concerning audit transparency in audit reports assessed through five items with 148 respondents has mean scores that range from 2.68 to 3.33 and standard deviation from 1.07 to 1.15 indicating neutral to slightly negative perceptions regarding the transparency of audit reports. The highest mean score 3.33 relating to the provision of details of key audit matters suggests a moderate level of confidence in this aspect while, the lowest mean score 2.68 regarding insights into financial performance reflects substantial skepticism with moderate variability signifying diverse opinions.

The moderate standard deviations 1.07 to 1.15 reflect varied perceptions potentially because of inconsistent report quality underscoring the necessity for enhanced clarity and detail in audit reports to enhance investor trust.

#### 4.3.4 Descriptive Statistics Analysis for Audit firm Reputation

Table 4.6

Items of Audit Firm Reputation	N	Mean	SD.
I have more confidence in financial statements audited by reputable firms than those reviewed by lesser-known firms.	148	2.304054	0.8544305
Audit firms with a strong reputation are more likely to conduct detailed and reliable audits.	148	3.331081	1.121154
The reputation of the audit firm influences my decision to invest in a company	148	3.932432	0.9665294
Audit firms with history of ethical conduct are more likely to maintain investor confidence	148	2.304054	0.8544305

Source: Research data (2025)

The reputation of audit firms (Table 4.6) evaluated through four distinct items involving 148 participants exhibits mean scores that range from 2.30 to 3.93 and Standard deviation from 0.85 to 1.12 illustrating a considerable diversity of perceptions regarding the effect of audit firm reputation on investor confidence within the Ethiopian context. The most elevated mean 3.93 denoting the influence of reputation on investment decisions signifies a strong consensus that reputable firms enhance trust conversely the lost mean 2.30 regarding confidence in reputable

firms and their ethical conduct indicates a notable degree of doubt with a moderate to low variability reflecting a certain level of agreements on unfavorable perceptions.

The fluctuating standard deviations from 0.85 to 1.12 signify heterogeneous perceptions emphasizing the necessity for reputable firms to strengthen ethical practices to consistently enhance investor confidence.

#### 4.3.5 Descriptive Statistics Analysis for Financial Reporting Quality

Table 4.7

Items of Financial Reporting Quality	N	Mean	SD.
The information presented in financial reports is reliable and free from material misstatements	148	3.331081	1.121154
I find financial reports to be a useful tool for assessing the financial health of companies	148	2.675676	1.07042
Financial reports are prepared in accordance with relevant accounting standards	148	2.675676	1.07042
The clarity and completeness of financial reports affect investor confidence	1148	2.939189	1.144204

Source: Research data (2025)

Financial reporting quality Table 4.7 evaluated through four distinct items with a total of 148 participants demonstrates mean scores that range from 2.68 to 3.33 and Standard deviation from 1.07 to 1.14 reflecting neutral to slightly adverse perceptions regarding the financial reporting. The highest mean score 3.3 associated with reliability and the absence of misstatements implies a moderate level of confidence whereas, the lower mean score 2.68 concerning the usefulness and compliance with established standards signifies a degree of uncertainty with moderate variability indicating a diverse opinion.

The moderate Standard deviations 1.07 to 1.14 reflect varied perceptions potentially arising from inconsistent reporting practices show the need for enhanced report clarity and compliance to increase investor trust.

### 4.3.6 Descriptive Statistics Analysis for Investor Confidence.

Table 4.8

Items of Investor Confidence	N	Mean	SD.
Investor more confident with financial report audited by the external auditors.	148	2.939189	1.144204
External auditors of Ethiopia are more trust worthy.	148	2.952703	1.241759
I believe audit report shows the correct financial status of the company.	148	2.47973	1.316921
Investor have greater confidence on financial reports audited by external auditors.	1148	3.331081	1.121154
Investors are more confident in investing in Ethiopia when auditors demonstrate trustworthiness and reliability.	148	2.128378	1.321102

Source: Research data (2025)

As shown in above Table 4.8 investor confidence evaluated through five items with 148 respondents shows mean scores ranging from 2.13 to 3.3 and Standard deviation 1.12 to 1.32 reflecting predominantly low to neutral perceptions of confidence in financial statements audited by external audits. The highest mean 3.33 for confidence in externally audited reports denotes moderate trust whereas, the lowest mean 2.13 for confidence in investment in Ethiopia when auditors' demonstration of trustworthiness illustrates considerable uncertainty with substantial variability indicating diverse opinions..

The high standards deviations 1.12 to 1.32 reflect varied experiences potentially due to inconsistent auditing practices or other variables within highlighting the need for improvement in all audited areas to strengthen investor trust.

### 4.3.7 Examination of Audited Financial statements.

This section presents a summarized analysis of actual audited financial statements data taken from AABE inspection reports for three companies in the automotive, Construction, Insurance and Audit firm. The findings highlight noncompliance with international Financial Reporting standards (IFRS) and International Standards on Auditing (ISA) which impacts financial reporting

quality on investor confidence. The AABE inspection report of each company's & audit firm noncompliance issues are discussed as follows:

### **Automotive Company Year End 31 December 2022**

The AABE inspection report for an automotive company, involved in importing, distributing and selling spare parts and accessories, identified noncompliance points with international Financial Reporting standards (IFRS). Key issues included the failure to disclose assumptions and estimation of uncertainties as required by IAS1, financial instruments were not recognized per IFRS 9 and impairment were incorrectly based on the incurred loss model of IAS 39 rather than the expected loss model of IFRS 9, cash and cash equivalents were not assessed for impairment, revenue was not presented in accordance with IFRS 15 lacking details on performance obligations and contract terms. These deficiencies indicate significant gaps in financial reporting transparency and reliability which are critical for investor decision making.

The noncompliance issues in the automotive company's financial statements undermine the quality of financial reporting as evidenced by the primary data's neutral to slightly negative perceptions of financial reporting quality (Table 4.7, mean range:2.68-3.33). The failure to implement IFRS 9 expected loss model and IFRS 15 revenue recognition requirements suggests that external auditors may lack the expertise or independence to enforce compliance aligning with moderate perceptions of audit independence (table 4.4: mean range 3.29-3.61)

### **Construction Company Year End 07 July 2022**

The AABE inspection report for a construction company identified noncompliance points. The highest among the reviewed company indicating severe deficiencies in financial reporting. Outstanding issues included the absence of disclosures for contingent liabilities and commitments per IAS 37 which limits transparency regarding potential financial obligation.

Contract assets were not separately presented as required by IFRS 15 and there was no evidence of impairment assessments for these assets under IFRS 9, liquidity risk disclosures such as, maturity analysis of financial liabilities were omitted that required per IFRS 7 and insufficient details was provided on revenue from contracts with customers including performance obligation and contracts per IFRS 15. These issues reflect weaknesses in both financial reporting and audit oversight.

The high number of noncompliance points in the construction company significantly impairs financial reporting quality align with the primary data's low mean scores for financial reporting usefulness and compliance with standards (Table 4.7 Mean 2.68). The lack of transparency in contract assets and liquidity risks likely contributes to investor uncertainty that investors can not accurately assess the company's financial health or risk exposure.

The construction company's noncompliance issues emphasize the need for enhanced audit quality to bridge the trust gap between company and users of financial statements. According to Ojo (2009) the role of external auditors in mitigating information asymmetry through rigorous audits yet the pervasive noncompliance suggests deficiencies in auditors expertise or regulatory enforcement.

### **Insurance Company Year End 30 June 2023**

The AABE inspection report for an insurance company identified noncompliance points with IFRS standards indicating notable key problems included insufficient disclosure of loans to key management personnel under IAS 24, omitting details on interest rates and current/noncurrent portions of loan, Investment property disclosure did not comply with IAS 40, Impairment losses on contract assets and cash equivalents were not adequately measured or reported per IFRS 9, Insurance contract liabilities were not measured using IFRS 17, the effect of exchange rate changes

on cash flows was omitted required per IAS 7 and provisions for Claim under litigation were insufficiently disclosed per IAS 37.

These noncompliance issues compromise the transparency and reliability of the insurance company's financial statements aligning with the primary data's low to neutral perceptions of investor confidence. (Table 4.8, Mean range: 2.13-3.33). The failure to disclose related-party transactions and impairment losses reduces the decision usefulness of financial reports limiting investor trust. The moderate perceptions of audit transparency (Table 4.5, mean range: 2.68- 3.33) suggest that auditors may not be effectively communicating critical audit matters further contributing to investor skepticism.

### **Audit Firm Engagement on insurance company for year end 30 June 2024**

The AABE inspection of the audit firm's engagement for the financial statements of an insurance company for year end 30 June 2024 reveals significant deficiencies in compliance with International Standards on Auditing (ISA) which undermine audit quality and investor confidence. The inspection highlights a gap in communication with those charged with governance (ISA 260) where the firm failed to document discussions on the audit reports, its form, scope and timing particularly regarding the client's transition from IFRS 4 and IAS 39 to IFRS 17, the firm's understanding of the entity's environment (ISA 315 and ISA 250) was inadequate as it did not document the client's accounting systems, internal controls, walkthrough procedures and compliance with relevant laws and regulations. These findings align with the study's descriptive statistics which indicate neutral to slightly negative perceptions of audit transparency (Table 4.5 Mean range: 2.68-3.33, SD: 1.07-1.15) suggesting that inconsistent adherence to standards and poor documentation practices as observed in the AABE inspection reports.

The AABE inspection identifies critical shortcomings in audit planning, documentation and sampling reinforcing the research's finding on the need for enhanced regulatory oversight to improve audit practice. The firm's planning process (ISA 240 and ISA 315) neglected to address a potential scope limitation arising from the IFRS 17 non implementing, evaluating the operating effectiveness of IT controls crucial for an insurance company with high transaction volume. Documentation deficiencies (ISA 230) and inadequate audit sampling procedures (ISA 530) that undocumented sampling methods and sample size for testing journal entries and internal control

indicate a lack of sufficient audit evidence compromising audit reliability highlighting the need for AABE to enforce stricter compliance with ISA through periodic inspections and penalties as recommended in the study Kesto & Bayeh ( 2021).

#### 4.5 Descriptive Analysis of Correlation

Correlation analysis serves to investigating the existence of a statically significant relationship between two variables. Field (2005). This analysis explains both the magnitude and the directionality of a linear association between the variables under consideration. In this study correlation coefficient is utilized to evaluate the relationship between the principal determinants of the investor confidence & other determinant to enhance investor confidence. The coefficient is expressed within a range of -1 to +1 where the sign showing the direction of relationship's nature that both Positive variables increase simultaneously while, negative increase as the other decrease.

According to Field (2005) a r value of +1 denotes a perfect positive correlation whereas, -1 signifies a perfect negative correlation. The intensity of the correlation is generally classified as values between  $\pm 0.10$  and  $\pm 0.29$  are indicative of a weak relationship, Value between  $\pm 0.30$  and  $\pm 0.49$  are suggestive of a moderate relationship and values ranging from  $\pm 0.50$  and  $\pm 1.00$  denote a strong relationship.

The outcomes of the correlation analysis concerning each determinate of investor confidences are presented in the below.

Table 4.9

	Invest~e	Financ~y	AuditF~n	AuditT~y	AuditI~e
InvestorCo~e	1.0000				
FinancialR~y	0.7999	1.0000			
AuditFirmR~n	0.5583	0.5470	1.0000		
AuditTrans~y	0.8128	0.8676	0.6176	1.0000	
AuditIndep~e	0.7515	0.6788	0.5834	0.7387	1.0000

The correlation matrix presented includes the dependent variable investor confidence, alongside four independent variables: Financial Reporting Quality, Audit Firm Reputation, Audit Transparency and Audit Independence. The correlation coefficient ranging from 0.5470 to 0.8676

indicates moderate to strong positive relationships among the variables providing understanding the manner in which auditing practices affect investor trust. Significantly the strong correlation between investor confidence and audit transparency 0.8128 and financial reporting quality 0.7999 imply that these factors serve as pivotal drivers of confidence whereas, audit firm reputation shows the weakest correlation 0.5583 denoting a lesser yet still positive influence.

The high correlation between audit transparency and financial reporting quality 0.8676 implies that transparent audit reports are closely linked to high-quality financial reporting supporting the effect of transparency and evaluating the impact of financial reporting quality. Additionally, audit independency demonstrates strong correlations with investor confidence 0.7515 and audit transparency 0.7387 supporting to analyze how the level of transparency and which the perceived auditor independence significantly enhances investor trust. The moderate correlation between audit firm reputation and other variables from 0.5470 to 0.6176 aligns with the impact of audit firm reputation on investor confidence and the reputation of the audit firm positively influences investor confidence in the reliability of financial statements suggesting that reputation plays a role but less influential than transparency and independence. The function of external auditors enhancing investor confidence while, audit firm reputations may yield a comparatively limited impact.

#### **4.6 Parametric Statistical Assumptions**

Before conducting regression analysis it is essential to test whether the data meet key statistical assumptions to ensure the validity and reliability of the model. These assumptions include reliability, normality, linearity, multicollinearity and homoscedasticity. Violation of these assumptions can distort regression. Therefore, diagnostic tests were performed to examine the fitness of the model for analysis. The results of each assumption test are presented and interpreted in the following sections.

##### **4.6.2 Multicollinearity**

According to Chirs (2008) Multicollinearity arise when two or more independent variables are strong correlated with each other. When this occurs the regression model struggles to determine

the individual effect of each independent variable on the dependent variable. Accordingly, multicollinearity was assessed using tolerance and Variance Inflation Factors (VIF) values and the results are shown below.

Table 4.10

. vif

Variable	VIF	1/VIF
AuditTrans~y	5.15	0.194288
FinancialR~y	4.10	0.244153
AuditIndep~e	2.36	0.423084
AuditFirmR~n	1.72	0.582977
Mean VIF	3.33	

The analysis of the Variance inflation Factor (VIF) evaluates the presence of multicollinearity among independent variables audit independency, audit transparent, audit firm reputation and financial reporting quality with the context of investor confidence. The VIF range from 1.72 audit firm reputation to 5.15 audit transparency with a mean VIF of 3.33 which indicating an overall moderate level of multicollinearity. Audit transparency and financial reporting show higher VIFs 5.15 and 4.10 respectively indicate a stronger intercorrelations however, VIF values falling below the threshold of 10 imply manageable multicollinearity. Whereas, audit independence 2.36 and audit firm reputation 1.72 suggest a lower level of multicollinearity. The findings are consistent with the acceptably threshold of multicollinearity.

### 4.6.3 Heteroscedasticity

As stated by Chris (2008) heteroscedasticity refers to the condition where the error terms show unequal variance across observations. When heteroscedasticity is present the estimators obtained through the ordinary squares (OLS) method become inefficient and the reliability of hypothesis testing is compromised due to underestimated variance and standard errors. To detect heteroscedasticity test was performed using Breusch-Pagan as shown in below.

**Table 4.11**

```
. hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Ho: Constant variance
Variables: fitted values of InvestorConfidence

chi2(1)      =      1.38
Prob > chi2  =      0.2407
```

The Breusch-pagan/Cook-Weisberg test for heteroskedasticity which was implemented on the fitted value of investor confidence produces a chi-square statistic of 1.38 accompanied by a p-value of 0.2407. This statistical test is aimed at evaluating the null hypothesis (Ho) affecting to the constancy of variance in the regression model that involves audit related variables. The P-value exceeding the threshold of 0.05 signifies an absence of significant evidence to reject Ho suggesting that heteroskedasticity does not a major critical issue.

#### 4.6.4 Normality

The investigation of normality was conducted both graphical (Normal probability Plot) and numerical (skewness and kurtosis) methodologies. In the graphical representation a straight diagonal line signifies adherence to normal distribution. Skewness and kurtosis values that lie within the range of -1 to +1 are indicative of normality. Conversely values that fall outside of this interval may denote a departure from normal distribution Gamst, Meyers and Guarino (2008). Normality test result shown in below.

**Table 4.12**

```
. sktest InvestorConfidence

Skewness/Kurtosis tests for Normality
----- joint -----
Variable | Obs Pr(Skewness) Pr(Kurtosis) adj chi2(2) Prob>chi2
-----|-----
InvestorCo~e | 148 0.3892 0.3000 1.84 0.3977

. histogram InvestorConfidence, normal
(bin=12, start=5, width=1.6666667)
```

In the analysis of skewness and kurtosis for the normality of investor confidence a joint chi-square statistic of 1.84 ( $p=0.3977$ ) is observed where the skewness (0.3892) and kurtosis (0.3000)  $p$ -values reflect no significant departure from the normality. The histogram of investor confidence ( $N=148$ , 12 bins,  $star=5$ ,  $width=1.67$ ) with a normal curve suggest a roughly normal distribution as supported by the skewness/kurtosis test ( $P=0.3977$ ). This visual confirmation of normality supports the use of parametric tests for Hypotheses.

#### 4.5.4 Ramsey RESET test

Gurjarati and porter (2009) introduces the Ramsey RESET test as a diagnostic instrument designed to identify specification errors particularly those arising from omitted variables or incorrect functional forms within regression analysis and suggest that the test involves regressing the dependent variable against the original predictors in conjunction with powers of fitted values with a significant F-test signifying potential misspecification as shown in below.

Table 4.13

```
. estat ovtest
```

```
Ramsey RESET test using powers of the fitted values of InvestorConfidence
Ho: model has no omitted variables
      F(3, 140) =      2.19
      Prob > F =      0.0920
```

The Ramsey RESET test for omitted variables in the regression model of investor confidence using powers of fitted value yields an F-statistic of 2.19 ( $df=3,140$ ) with a  $p$ -value of 0.0920. This tests the null hypothesis ( $H_0$ ) that the model no omitted variables relevant to the study general objective of analyzing the role of external auditors this supports the validity of recession analysis testing sated Hypotheses.

## 4.6 Multiple Regression Analysis

Multiple regression analysis was used to assess how four key factors Independent Variables: Audit Independence, Audit Transparency, Audit Firm Reputation and Financial Reporting Quality influence investor confidence. This model predicts the linear relationship between a dependent and a multiple independent variable. The coefficient indicates whether the effect is positive or negative. The R-Square explains how much of the variations in investor confidence is due to these factors. The constant reflects the baseline level of investor confidence when predictors are zero and the P-value and t-statistics help determine the significance of each variable in the model.

### 4.6.1 Model of regression Summary

*Table 4.14*

Source	SS	df	MS	Number of obs	=	148
Model	1900.9025	4	475.225625	F(4, 143)	=	101.15
Residual	671.874527	143	4.69842326	Prob > F	=	0.0000
				R-squared	=	0.7389
				Adj R-squared	=	0.7315
Total	2572.77703	147	17.5018845	Root MSE	=	2.1676

The regression analysis conducted on investor confidence incorporating independent variables such as audit independence, audit transparency, audit firm reputation and financial reporting quality produces a model of considerable significance ( $F(4,143)=101.15, p<0.0000$ ) indicating that these predictors collectively explain a substantial portion of variance the role of external auditors. The R-squared value of 0.7389 shows that 73.89% of the variability in investor confidence is explained by the model with the adjusted R-squared of 0.7315 shows the model's strong explanatory capacity after adjusting for the number of predictors included. The root means Square error (RMSE) of 2.1676 denotes a moderate level of prediction error concerning Investor confidence suggesting a good fit for the model.

## 4.6.2 ANOVA

Table 4.15

```
. anova InvestorConfidence AuditIndependence AuditTransparency AuditFirmReputation FinancialReportin
> gQuality
```

```
Number of obs =      148    R-squared      = 0.8411
Root MSE      = 2.14318    Adj R-squared = 0.7376
```

Source	Partial SS	df	MS	F	Prob>F
Model	2163.98	58	37.31	8.12	0.0000
AuditInde~e	253.48258	19	13.341188	2.90	0.0004
AuditTran~y	127.68914	18	7.093841	1.54	0.0935
AuditFirm~n	98.713235	11	8.9739305	1.95	0.0427
Financial~y	69.995228	10	6.9995228	1.52	0.1440
Residual	408.79704	89	4.5932252		
Total	2572.777	147	17.501885		

The ANOVA conducting for Investor confidence utilizing independent variables such as audit independence, audit transparency, audit firm reputation and financial reporting quality results in a model of substantial significance ( $F(58,89) = 8.12$ ,  $P < 0.0000$ ) explaining 84.11% of the variance  $R\text{-square} = 0.8411$  and adjusted  $R\text{-square} = 0.7376$  supporting the general objective of evaluating the role of external auditors in enhancing investor confidence. Audit independence ( $F=2.90$ ,  $P=0.0004$ ) and audit firm reputation ( $F=1.95$ ,  $P=0.0427$ ) shows significant contribution to investor confidence whereas, audit transparency ( $F=1.54$ ,  $P=0.0935$ ) and Financial reporting quality ( $F=1.52$ ,  $P=0.1440$ ) presents non-significant p-values indicating weaker support for respective hypotheses.

### 4.6.3 Regression Coefficients

Table 4.16

InvestorConfidence	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
AuditIndependence	.3154544	.0696267	4.53	0.000	.1778238	.453085
AuditTransparency	.3169294	.1072234	2.96	0.004	.1049817	.528877
AuditFirmReputation	.0353913	.0833329	0.42	0.672	-.1293322	.2001148
FinancialReportingQuality	.4205317	.1081651	3.89	0.000	.2067226	.6343408
_cons	-1.595357	.8786934	-1.82	0.072	-3.332264	.1415493

By referring to the above analysis the regression equation for the role of external auditors to enhance investor confidence formulated as:

Statistical equation as per Model : (  $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + E \dots$  ) is

$$IC = -1.595357 + .315454AI + .3169294AT + .0353913AFR + .4205317FRQ$$

The multiple regression analysis for investor confidence with independent variables audit independence, audit transparency, audit firm reputation and financial reporting quality explains significant positive effects. Audit independence ( $\beta = 0.315$ ,  $t = 4.53$ ,  $p < 0.000$ ) and financial reporting quality ( $\beta = 0.421$ ,  $t = 3.89$ ,  $p < 0.000$ ) demonstrate strong positive influences confirming the Hypotheses indicating that greater independence and superior quality of financial reports substantially raise investor trust. Additionally, Audit transparency ( $\beta = 0.317$ ,  $t = 2.96$ ,  $p < 0.004$ ) also exerts a positive impact on hypothesis. Finally audit firm reputation ( $\beta = 0.035$ ,  $t = 0.42$ ,  $p < 0.672$ ) is deemed non-significant suggesting limited support hypothesis implying that the reputation possess negligible influence.

### 4.7 Interpretation of Regression Analysis in Terms of Research Hypotheses.

#### **H1: Auditor independence positively influences investor confidence**

The regression coefficient for Audit independence ( $\beta = 0.315$ ,  $t = 4.53$ ,  $p < 0.000$ ) is positive and highly significant providing strong support for hypothesis H1. This indicate that a 1% increase

in audit independence increase investor confidence by 31.5% confirming its critical role in enhancing trust in financial statements that high independence of external auditors enhances investor Confidence.

**H2: Higher transparency in audit reporting increases investor confidence in Financial Statements.**

Audit Transparency's coefficient ( $\beta = 0.317$ ,  $t=2.96$ ,  $p<0.004$ ) is positive and significant supporting hypothesis H2. A 1% increase in audit transparency raises investor confidence by 31.7% indicates that a good transparency in audit reports enhance investor confidence.

**H3: The reputation of the audit firm positively influences investor confidence in the reliability of financial statements.**

The coefficient for audit firm reputation ( $\beta = 0.035$ ,  $t=0.42$ ,  $p<0.672$ ) is positive but not significant failing to support hypothesis H3. This suggest that audit firm reputation has a negligible impact on investor confidence indicating limited influence investor confidence.

**H4: The quality of financial reporting increases investor confidence in Financial Statements.**

Financial reporting quality's coefficient ( $\beta = 0.421$ ,  $t=3.89$ ,  $p<0.000$ ) is positive significant and strongly support Hypothesis H4. That 1% increase in reporting quality enhance investor confidence by 42.1% which is align with the high quality of financial reporting and underscoring a pivotal role in increasing investor trust.

## CHAPTER FIVE

### SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

#### 5. INTRODUCTIONS

This chapter presents a summary of the major findings, draws conclusions focused on the key determinants that significantly influence the role of external auditors in enhancing investor confidence and offers recommendations based on the study's results as well as provides directions for future research. The conclusion and recommendations are specifically based on the study's core variables: audit independence, audit transparency, audit firm reputation and financial reporting quality.

#### 5.1 Summary of Findings

- The regression analysis confirmed a significant positive correlation between audit independence and investor confidence supporting auditor independence positively influences investor confidence which suggested that audit independence exerts a favorable influence on investor confidence. Descriptive statistics revealed moderate perceptions regarding independence indicating a strong confidence in auditors acting in the interest of investor while, concerns regarding fees and prolonged relationships potentially compromising objectivity. The correlation analysis further emphasized a strong association investor confidence with audit independence and the existing literature underscores independence as a fundamental principle of audit quality.
  
- Audit transparency exerted a significant influence on investor confidence collaborating with hypothesis which asserts that enhanced transparency in audit reporting enhance investor confidence in financial statements. However, descriptive statistics shows comparatively weaker observation with low scores in terms of understandings to financial performance signifying a deficiency in the clarity of audit reports. The distinct correlation

with investor confidence and financial reporting quality increase the level of transparency in audit reports increase investor confidence.

- The regression findings revealed a non-significance effect of audit firm reputation on investor confidence failing to validate Hypothesis which anticipated that audit firm reputation positively affects investor confidence regarding the reliability of financial statements. Descriptive statistics reflected mixed perceptions indicating a high degree of confidence in reputation influencing investment decisions yet a low level of trust in ethical practices. The comparatively weaker correlation audit firm reputation with investor confidence suggesting a limited impact of reputation potentially attributable to the presence of lesser-known firms in Ethiopia.
- Financial reporting quality demonstrated the most pronounced significant effect on investor confidence strongly supporting Hypothesis which states that strong financial reporting enhances investor confidence in financial statements. Descriptive statistics indicating neutral to slightly negative observations with concerns regarding adherence to established standards. The strong correlation supporting further reinforcing the critical importance of high-quality reporting.

## **5.2 Conclusion**

This research effectively accomplished the general objective of analyzing the role of external auditors in enhancing investor confidence offering empirical confirmation through a qualitative survey involving 22 partnership audit firms alongside their clients in Addis Ababa. The results confirm that external auditors exert a considerable impact on investor confidence particularly audit independence and the quality of financial reporting which are critical in sectors. The substantial support of auditor independence positively influences investor confidence and the quality of financial reporting increases investor confidence in Financial Statements emphasizes the criticality of independent auditors and superior quality financial reports in mitigating information asymmetry and developing trust in accordance with agency and stakeholder theoretical frameworks

The moderate confirmation for higher transparency in audit reporting increases investor confidence in Financial Statements stresses the significance of audit transparency. However, it's limited clarity in practical application indicates a deficiency is satisfying investor expectations.

The absence of support for the reputation of the audit firm positively influences investor confidence in the reliability of financial statements suggests that the reputation of audit firm's reputation has minimal influence possibly due to developing phase of Ethiopia's audit market and the predominance of smaller firms.

The outcomes of the study align with the literature underscoring the significance of audit quality in stimulating investor trust .

The 89% response rate and the diverse of respondent, 40.54% possessing over 10 years of experience and the qualification of respondent possess increase the reliability of the findings even if, the study concentrated on partnership firms limits the applicability of the results to sole proprietorships.

In general, the study confirms that external auditors play a vital role in enhancing investor confidence. However, improvement in transparency and the quality of reporting are needed to align with international standards and increase investor trust.

### **5.3 Recommendations**

Based on the conclusions drawn from the research this investigation provides reasonable recommendations for various stakeholders such as policymakers, the Accounting and Auditing Board of Ethiopia (AABE), auditing firms and their clients aimed at fortifying the role of external auditors in enhancing investor confidence. These recommendations specifically recognized difficult in harmonizing financial reports with International Financial Reporting Standards (IFRS) and maintaining audit quality in accordance with International Standard on Auditing (ISA).

In light of the substantial impact of audit independence it is for AABE to implement more strict guidelines to alleviate threats to independence such as self-interest and familiarity threats. The systematic rotation of audit partners as well as audit firms can effectively diminish conflict of familiarity threats. Furthermore, audit firms should establish strong internal control to ensure

objectivity particularly in relation to fees and provide training to audit teams focused on professional skepticism as advocated by to improve audit transparency AABE ought to mandate the incorporation of Key Audit Matters (KAMs) in audit reports.

The financial reporting quality is a significant factor for investor confidence. In study the presence of compliance challenge with IFRS and other issues includes inconsistent application of IFRS due to limited experts and insufficient training accordingly AABE should encourage audit firms & their clients to update themselves on IFRS training to ensure the accuracy, relevance and timelines of reporting to maintain quality of financial reporting in order to increases investor confidence in Financial Statements. AABE also perform periodic inspection and penalties companies which non-compliance to IFRS in order to improve reporting quality.

The finding of this study alongside secondary data shows that audit quality in Ethiopia frequently does not meet ISA as mandated by AABE .The issues identified include limited implementation of ISA criteria for risk assessment and fraud detection which can be partially attributed to resource constraints and inadequate regulatory oversight. AABE should enhance enforcement through periodic inspection and penalties for non-compliance inorder to ensuring the audits adhere to ISA.

It is important that policymakers rectify the existing regulation deficiencies in Ethiopia as the limitations in financial reporting and audit quality are largely attributed to inadequate enforcement mechanisms. The Accounting and Auditing Board of Ethiopia (AABE) must try to harmonize local regulation with international recognized best practice to establish strong governance frameworks.

Future researchers should widen their investigation to include sole proprietorship audit firms to facilitate a more compensative representation and including additional determinate such as regulatory adherence. Investigating IFRS and ISA compliance challenge including AABE inspection effectiveness would further increase understanding of audit quality's impact on investor trust to supporting ivestor trust and contributing to academic and practical advancement in the audit profession.

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## 7. ANNEXES

### 7.1 QUESTIONNAIRE

#### PART ONE: Demographic variable

1) **Gender:** Male  Female

2). **Age:**

20 - 30 Years

30 - 40 Years

40 - 50 Years  Above 50 Years

3). **Level of Education:** (Select all that apply)

Diploma  Bachelor Degree  Masters  PHD  ACCA

4) **Your role:**

Senior Auditor  Audit Manager  Director  Partner  Finance Manager

General Manager  Finance Manager  Other: \_\_\_\_\_

5). **Work Experience:**

Less than 3-year  3-5-year  6-10 year  More than 10 years

**PART TWO: Determinants of Investor Confidence**

Please indicate your level of agreement (whether you agree or disagree) with each statement using the scale below as a guide: put (√) on your selection.

**1= Strongly Disagree (SD) 2= Disagree (D) 3= Somehow Agree (N) 4= Agree (A) 5= Strongly Agree (SA)**

S/N	Dimensions	SD	D	N	A	SA
<b>I.</b>	<b>Audit Independence</b>					
<b>1</b>	External auditors are free from undue influence from the company they audit.					
<b>2</b>	I believe external auditors act in the best interest of investors even when it conflicts with management desires.					
<b>3</b>	External auditors independently challenge management accounting when needed.					
<b>4</b>	The fees paid to external auditors do not compromise their objectivity.					
<b>5</b>	External auditors maintain objectivity even in long term relationships with clients.					
<b>II.</b>	<b>Audit Transparency</b>					
<b>1</b>	Audit reports clearly explain the scope of the audit.					
<b>2</b>	Audit reports provide sufficient details about key audit matters and significant risks.					
<b>3</b>	Au reports are written in a clearly and concisely ensuring financial statement users can easily understand their content and conclusion.					

4	Audit reports provide valuable insights into the company's financial performance and internal controls.					
5	External auditors openly report financial irregularities.					
<b>III.</b>	<b>Audit Firm Reputation</b>					
1	I have more confidence in financial statements audited by reputable firms than those reviewed by lesser-known firms.					
2	Audit firms with a strong reputation are more likely to conduct detailed and reliable audits.					
3	The reputation of the audit firm influences my decision to invest in a company.					
4	Audit firms with history of ethical conduct are more likely to maintain investor confidence.					
<b>IV.</b>	<b>Financial Reporting Quality</b>					
1	The information presented in financial reports is reliable and free from material misstatements					
2	I find financial reports to be a useful tool for assessing the financial health of companies.					
3	Financial reports are prepared in accordance with relevant accounting standards					
4	The clarity and completeness of financial reports affect investor confidence					
<b>V</b>	<b>Investor Confidence</b>					
1.	Investor more confident with financial report audited by the external auditors.					

2	External auditors of Ethiopia are more trust worthy.					
3	I believe audit report shows the correct financial status of the company.					
4	Investor have greater confidence on financial reports audited by external auditors.					
5	Investors are more confident in investing in Ethiopia when auditors demonstrate trustworthiness and reliability.					

**Other Comments:** Please provide any additional comments or suggestions regarding The Role of External Auditors in Enhancing Investor Confidence.

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**THANK YOU FOR YOUR COOPERATION!!**