

Project Paper on the Title “Auditors Professional
Responsibilities and Legal Liability with Regard to Private
Auditors in Ethiopia”: For the Fulfillment of M.Sc
Program in Accounting and Finance

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Statement of Certification

This is to certify that Muluneh Beyene has carried out his research work on the topic entitled “The Auditors Professional Responsibilities and Legal Liability with Regard to Private Auditors in Ethiopia”

The work is original in nature and is suitable for submission for the reward of the M.Sc Degree in Accounting and Finance.

Advisor: Professor Johannes Kinfu

Statement of Declaration

I, Muluneh Beyene, have carried out independently a research work on “The Auditors professional responsibilities and legal liability with regard to private auditors in Ethiopia” in partial fulfillment of the requirement of the MSc program in Accounting and Finance with the guidance and support of the research advisor.

This study is my own work that has not been submitted for any degree or diploma program in this or any other institution.

Muluneh Beyene

July, 2007

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Ethiopia

Acronyms/Abbreviations

ACCA:	Association of Chartered Certified Accountants.
EPAAA:	Ethiopia Professional Association of Accountants and Auditors
OFAG:	Office of Federal Auditor General.
GAAP:	Generally Accepted Accounting Principles
GAAS:	Generally Accepted Auditing Standards
U.S. GAO:	United States Government Accountability Office
SAS:	Statements on Auditing Standards
IFAC:	International Federation of Accountants

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Table 1 Personal information of manager respondents

No	Items	Responses	
		No	%
1	Sex: a) Male	9	73.33
	b) Female	<u>2</u>	<u>26.67</u>
	Total	11	100
2	Nationality:		
	a) Ethiopian	11	100%
	b) Non-Ethiopian	<u>0</u>	<u>0</u>
	Total	11	100%
3	Educational qualification		
	a) Ph.D	2	18.18
	b) MA/MSc	4	36.37
	c) BA/BSc	3	27.27
	d) College Diploma	-	-
	e) Certificate	<u>2</u>	<u>18.18</u>
	Total	11	100

Annex - 2

Table 2 Characteristics of the sampled organizations/firms:

No	Items	Responses	
		No	%
1	Business Type:		
	a) PLC	6	54.55
	b) Share Company	3	27.27
	c) NGO	<u>2</u>	<u>18.18</u>
	Total	11	100
2	Category of business		
	a) Constriction	1	9.09
	b) Manufacturing	3	27.27
	c) Merchandising	5	45.46
	d) NGO	<u>2</u>	<u>18.18</u>
Total	11	100	
3	Year of establishment of the firm on average:		
	a) Less than 2 years	1	9.09
	b) 3 to 5 years	2	18.19
	c) 5 to 10 years	4	36.36
	d) Older than 10 years	<u>4</u>	<u>36.36</u>
Total	11	100	
4	Annual profit on average:		
	a) 10,000 - 50,000	2	18.18
	b) 50,000 - 100,000	5	45.46
	c) 100,000 - 500,000	3	27.27
	d) Above 500,000	<u>1</u>	<u>9.09</u>
Total	11	100	
5	Have branch in other country:		
	a) Yes	0	0
	b) No	<u>11</u>	<u>100</u>
Total	11	100	

Abstract

This study was conducted on the Ethiopian private auditor's professional responsibilities and legal liability, in comparison with those developed countries auditing principles and standards. The paper tested the responsibilities of the management and the auditors with regard to preparation of the financial statements and subsequent discovery to misstatements to the audited financial statements in Ethiopia. The paper qualitatively estimated to what extent private auditors exercise their professional and legal responsibilities. The paper also tested the legal consequences on auditors as a result of those violated professional and legal responsibilities. Besides it tested that to which auditors are liable for the violation of contractual and statutory responsibilities. Further the study tried to explore the constraints related to private auditors in exercising their responsibilities. Finally, not the least the paper explored some cases related to Ethiopia private auditors' practices.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

It is the responsibility of the management to apply accounting standards when communicating with investors and creditors through the financial statements. Another group, auditors, serves as an independent intermediary to help ensure that management has in fact appropriately applied GAAP in preparing the entities financial statements. Auditors examine or audit financial statements to express a professional independent opinion. The opinion reflects the auditors' assessment of the statements "fairness" which is determined by the extent to which they are prepared in compliance with GAAP.

Supporting this Johannes says, auditors examine financial statements and lend credibility to the reports of enterprise verifying that financial and economic facts do portray the entity's progress and financial position. The quest for developing a means for achieving better and more informative and reliable financial reports is continuous and not static. If financial reports are to be intelligible and of use to different groups, then, there must be a dialogue to shape the basis for accounting "common interest". (Johannes: 1994).

As per Foulks assumption generally, the objective of an external audit is to express an opinion on whether the financial statements of an entity are prepared in accordance with Generally Accepted Accounting “principles (Foulks lynch: 2003). This means that the auditors can not guarantee that the financial statements are free of fraud or error because of the inherent limitations of the audit.

As Meigs, Whittington, Pany, Meigs and Lam say, financial statements to be in accordance with generally accepted accounting principles, they must be free from material misstatement. Therefore, the auditors have a responsibility to detect various types of misstatements, including errors, fraud, and those caused by certain illegal acts (Meigs, Whittington, Pany, Meigs and Lam: 1992).

GAAS require the auditors to design their audit procedures to reduce the risk of not detecting a material misstatement resulting from error, unintentional misstatements in financial statements, or fraud, intentional misstatement in financial statements, to an appropriate low level. Accordingly, the auditors must exercise due professional care in planning, performing, and evaluating the results of audit procedures. They also must exercise the proper degree of professional skepticism by not assuming unquestioned honesty and good faith on part of management.

As a responsibility, the auditors should inform the appropriate level of management about material misstatements. For example if fraud is detected, the level of management to inform is usually at least one level above those suspected to be involved in the fraud. Also the audit committee of the client's board of directors should be informed of any significant misstatements. The statement of auditing standards describes the basic principles which govern the auditors professional responsibilities and which must be complied with whenever an audit is carried out. It provides a framework within which professional judgment must be exercised and establish the minimum standard to be followed on individual audits. (Arens and Loebbecke: 1991)

As RJ Anderson FCA says, auditors' professional responsibilities are governed by the rules of professional conduct whose enforcement is handled exclusively by the recommendations of GAAS (Generally Accepted Auditing Standards). (RJ Anderson FCA: 1984).

In addition to professional responsibilities, auditors should respect legal responsibility. The auditors legal responsibility can be statutory, contractual, and tort.

RJ Anderson FCA Pointed out that, ideally legal responsibilities should constitute a minimum standard which professional responsibilities

exceed. Occasionally, however, a legal standard may exceed promulgated professional rules. The courts will often turn to though they are not necessarily bound by, professional pronouncements in interpreting a legal standard due care. (RJ Anderson FCA: 1984). From these RJ Anderson concludes legal responsibilities of the external, auditors arise from one or more of statutes, contract and tort.

Also as Meigs, Whittington, Meigs and Lam stated the auditors legal responsibility can be statutory, contractual or both. (Meigs, Whittington, Meigs and Lam: 1987).

FTC Foulcks lynch on ACCA paper 3.1 (Audit and assurance service) stated that auditors should report to members on whether the financial statements of the company show a “true and fair view “or “present fairly” the finical position. Also specific duties such as to consider whether the information in the management report is consistent with the financial statements and whether proper accounting records have been kept by the company were also considered.

Accordingly, such statutory responsibilities impose liabilities if things go wrong. Auditor's liabilities in most countries can be categorized as liability under legislation either civil or criminal (in counties with civil

code legal traditions) and liability arising from negligence under common law (in countries with common law legal traditions).

Some writers conclude that, those who fail to fulfill their professional and legal responsibility satisfactorily may be faced with legal action. Thus, public accountants must be keenly aware of their legal responsibility and liability. (Megis, Whittington, Meigs, Pany and Lam: 1992)

Hence, this study is designed to describe the auditors' professional responsibility and legal liability with reference to private auditors in Ethiopia. The findings and the conclusions drawn from the study will help all concerned bodies in the country to be aware of the existing practice and to address the problem of failure to fulfill the professional and legal responsibility.

1.2 Statement of the problem

In most cases the users of financial statements of an entity prefer audited financial statements for making rational decisions. However, in developing countries like Ethiopia, the awareness creation and efficient practices of the auditors has not yet developed very well. The student researcher in five years of work experience has observed auditor acting in what may seem illegal during examination of the financial statements of

an entity. Thus, it is his belief that some auditors in Ethiopia may be releasing misleading audited financial statements. There is a reason of believe that private auditors of Ethiopia may have been producing misleading audited financial statements by:

- Reporting assets that do not exist,
- Considering or not disclosing inadequate provision for doubtful debts,
- Reporting stock records disregarding stock inventory counts,
- Treating capital expenditures as periodic expenses,
- Not disclosing misapplication of accounting principles,
- Expressing the audit opinion based on the client's interest and others.

Generally, as the researcher observed from the last five years audit experience, there is reason to conclude, some private auditors of Ethiopia have been violating auditors' professional responsibilities. That is, most of the time violation of professional responsibilities is for the sake of personal financial interest.

Therefore, the purpose of this study was to find out the practice of some private auditor's in exercising the professional and legal responsibility in Ethiopia. Also this study was designed to explore whether the consequence of violation of these responsibilities is exposed and prosecuted at all.

1.3 Purpose and Objective of the Study

The general objective of the project paper was to examine the auditor's professional responsibilities and legal liability in Ethiopia. In light of this, the specific objectives of the project include the following:

- to identify the sources of and audit requirement mandated by the international and local organizations,
- to infer the auditors professional and legal responsibilities and rationale therefore,
- to identify the responsibility of directors (management) and auditors with regard to financial statements and subsequent to the discover of misstatements to audited financial statements,
- to identify the major legal concepts that relate auditors' liability to clients and third parties under common law,

Hence, having the above objective this project paper was designed to answer the following basic questions.

- To what extent do private auditors exercise their professional and legal responsibilities?
- To what extent does the client prepare financial statements for easy verification?
- Are private auditors subject to legal liability for committing what may be seem illegal audit practices?

- What constraints exist on private auditors in attempting to exercise their responsibility?

1.4 Research Methodology

For these objectives to be achieved secondary data was one source of information which was gathered from:

- The Office of Federal Auditors General(OFAG),in order to identify the sources of and audit requirement mandated by the international and local organizations, and to infer the auditors professional and legal responsibilities and rationale therefore;
- The EPAAA in order to explore that to what extent do private auditors exercise their professional and legal responsibilities?
- Commercial code of Ethiopia, in terms of the major legal concepts that relate auditors' liability to clients and third parties under common law, and
- Other publications such as news paper, magazines, Journals and others, in terms of some violated professional and legal responsibilities, and legal action taken at all.

The study also employed a primary data which was gathered using questionnaires and interview in terms of the auditors professional and legal responsibilities, the responsibility of directors (management) and auditors with regard to financial statements and subsequent to the discovery of misstatements to audited financial statements, and the

constraints exist on private auditors in attempting to exercise their responsibility.

This was done by distributing a questionnaire to a sample of selected auditee (organization or firms to be audited) management. The survey questioner was made on fifteen organization managers found in Addis Ababa. And the interview was administered to seven samples of selected audit firm's managers.

Moreover, two cases were analyzed in order to fulfill the objective of the study. Thus, due to the confidentiality nature of information sources the researcher was unable to access to the right data. Hence, in order to prove that whether the auditors' professional responsibilities were impaired and the legal consequence on such violated responsibilities the cases were analyzed.

To make the final result dependable and significant for users of the information, great care was taken at the time of collection and editing. The researcher gathered the list of target organization or firms along with their telephone number, fax number, post number, and for some of them e-mail address from the chamber of commerce business directory and from the sampled organizations or firms office. Having this data the

researcher reached the managers of the organization or firms and gathered their opinion.

The researcher purposive sampled the above sources of primary data. In this paper the researcher had employed tables to analyze the survey results.

1.5 Significance of the Study

Users of financial statements of an entity mostly depend on audited financial statements. During conducting an audit auditors should exercise due professional care, and should follow auditing standards formulated by international organization as well as local government body. Violation of these standards may subject to legal liability to auditors’.

Hence, the study intended to clarify the auditors’ practices in exercising professional and legal responsibility and the legal liability subject to not fulfilling these responsibilities in Ethiopia.

Therefore, this study was significant for the following major reasons;

- the findings of the study may create awareness on auditors professional responsibility and legal liability among educators, students, shareholders and all other concerned;

- it may help all concerned bodies in addressing some of the problems related to violation of professional and legal responsibility by an auditor;
- the findings of the study may help as a basis for further research and discussions;
- the study may contribute to the sum total of the body of knowledge.

1.6 Scope and Limitation of the Study

In most developing countries, like Ethiopia, accounting and auditing profession has not yet developed. Thus, Ethiopia is among these countries where there are no locally developed auditing standards.

Supporting the above Lemma and Assefa argued that, to date in Ethiopia, there were no nationally promulgated standards to be followed by auditors, but it was widely known that Generally Accepted Auditing Standards (GAAS) have been adopted by practically all auditors in private sector. It is expected that, on the basis of GAAS, private auditors plan, control, record their audit work undertaken, review accounting systems and internal control, collect and access audit evidences and review financial statements to draw reasonable conclusions to form their opinion to culminate in final reports (Lemma Argaw and Assefa Desta: 1994).

Also Tesfaye Mengasha on his article concluded that, Ethiopia is among those countries where there are no locally developed standards. Accordingly, those developed elsewhere have generally been adopted. However, it is saddening to note the following conditions under which local auditors are being subjected to, summarized here briefly:

- Outdated regulation (e.g. Commercial code of Ethiopia of 1960!)
- Insufficient quantity and quality of accountants responsible for handling the accounting and reporting function.
- Weak management information systems (MIS)
- Weak governance and controls by those responsible.
- Weak regulation/ monitoring are themselves - motivated or otherwise.
- Ineffective/ inappropriate steps by those responsible for certification and monitoring.
- Weak investors' and general public awareness sometimes resulting in expectation gaps.
- Insufficient level of fees being raised.
- Inappropriate methods of contracting audit assignment to the extent of becoming incapable of preserving the auditor's independence.
- Inappropriate, and unethical practices by the practitioners themselves.(Tsfaye Mengasha:2003)

From the above, one can say that in Ethiopia there is a lack of internally established accounting and auditing standards. Accordingly, private auditors of Ethiopia mostly depend on auditing standards established by developed countries specially U.S and U.K. Hence, the study depends on those standards developed by international professional association and those adopted from international standards.

Therefore, in addition to the above facts the project paper has the following limitations:

- Due to the confidentiality nature of information there was no access to the right data,
- Organization or firm's managers disappointing and/or not punctual to appointments,
- Shortage of finance,
- Shortage of internet facility,
- Lack of recent publication in relation to the project title, and
- Lack of past studies relevant to the project paper title.

1.7 Definition of Key Terms

Terms that will have a unique meaning for the purpose of this study are defined as follows:

Private auditors: are also called external auditors. External auditors are professional accountants who audit the financial statements of the organizations in order to add credibility to the financial information. (Meigs Whittington Meigs and Lam: 1987)

Professional responsibilities: Professional responsibilities are the competence, judgment and integrity of personnel of an audit service rendering firm, (Meigs Whittington, Pany and Meigs and Lam: 1992)

Legal responsibility: the auditors' legal responsibility can be statutory, Contractual and tort. Statutory responsibilities are the responsibilities to appoint auditors, independence of auditors, responsibility to report, responsibility to make examination, responsibility to attend meetings, responsibility to hold office, and local legislation. Contractual responsibilities are responsibilities to statutory audit engagements, and non-audit engagements. A tort is a private or civil wrong. (RJ Anderson FCA: 1984)

Legal liability: auditor's litigation in which persons with real or fancied grievances are likely to take their grievances to court. (RJ Anderson FCA: 1984)

Authorized auditors: professional accountants who received certificate of professional competence from the office of Office of the

Federal Auditor General (OFAG) and authorized to provide auditing and related services to audit clients. (OFAG: 2004)

Professional services: any services requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting, system design and development and financial management services. (OFAG: 2004)

Audit client (auditee): an entity in respect of which a professional accountant conducts an audit engagement. (OFAG: 2004)

1.8 Organization of the Paper

The paper has five chapters. Chapter one presents the introduction part containing statements of the problem and research methodology. Chapter two presents a critical review of the related literature. Chapter three reviews the Ethiopian practice on auditor's professional responsibilities and legal liability. Chapter four contains the data analysis and presentation; and case analysis. The paper ends with major findings, conclusion that summarizes the main results of the study and gives some recommendations in the fifth chapter.

CHAPTER TWO

REVIEW OF THE RELATED LITERATURE

2.1 Auditors Rule of Professional Conduct

The ethical base of auditing has an ethical guide known as the rules of professional conduct. (Foulks lynch: 2004). The main areas of these rules are:

1. the fundamental principles;
2. integrity, objectivity, and independence;
3. confidentiality ;
4. changes in professional appointments;
5. fees;
6. ownership of books and papers;
7. conflicts of interest.

The fundamental principles in professional conduct involve integrity, objectivity, competency, exercising due professional skills, and behaving with courtesy and consideration. (Foulks lynch: 2004). Members should behave with integrity in all professional, business and personal financial relationships. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other. Auditors should not accept or perform work which they are not competent to undertake unless they obtain such advice and assistance as will enable them

competently to carry out the work. Also they should carry out their professional work with due skill, care, diligence and courtesy. (Foulks lynch: 2004)

In carrying their duty auditors should be independent of the client, such independence is in terms of fees, family relationship, and other interests. For instance, it is recognized that a dependence on income from a particular client or group of clients may impair objectivity. So that, a firm which derives most of its income from one client may find it difficult to make a stand on a particular issue, as a loss of that client would have a disastrous effect on the firm's financial position (Foulks lynch: 2004).

Auditors' working papers are their own property and any request for their production should be refused. However, if the taxation authority requests the production working papers relating to a particular client whose affairs are under investigation, auditors should ensure their response is in the best possible interests of the client. (Foulks lynch: 2004).

As per Arens and Loebbecke the AICPA code of professional conduct consists of general statements of ideal conduct or specific rules that define unacceptable behavior. (Arens and Loebbecke: 1991).

Thus, the code consists four parts; principles, rules of conduct, interpretations, and ethical rulings; which are listed in order of increasing specificity. (Arens and Loebbecke: 1991). The ethical principles are ideal standards of ethical conduct stated in philosophical terms but are not enforceable. These principles include that;

- members should exercise sensitive professional and moral judgments in all their activities;
- members should accept the obligation to act in a way that will serve the public interest; honor public trust, and demonstrate commitment to professionalism;
- members should perform all professional responsibilities with the highest sense of integrity;
- member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities;
- a member in public practice should be independent in fact and appearance when providing auditing and attestation services; and
- member should observe the professional's technical and ethical standards or simply exercise due professional care.

The rules of conduct are minimum standards of ethical conduct stated as specific rules which are also enforceable. This part of the code includes the explicit rules that must be followed by every CPA in the practice of public accounting.

The need for published interpretations of the rules of conduct arises when there are frequent questions from practitioners about a particular rule, for this reason these parts are not enforceable. The ethical rulings, which are highly specific, are explanations by the executive committee of AICPA to questions about the rules of conduct.(Arens and Loebbecke: 1991).

Also Meigs, Whittigton, Pany, Megis and Lam pointed out that the rules of professional conduct of various provincial institutes consist of three parts;

- Fundamental principles; such as members responsibility to the public and the profession; integrity, due care, and competence; objectivity; and responsibilities to clients and colleagues,
- Applicable and enforceable rules of conduct, and
- Interpretations of rules of professional conduct. (Meigs, Whittigton, Pany, Megis and Lam: 1992).

Therefore, from many writers' explanations one can conclude that the rules of professional conduct adopted by public accountants in most countries are similar in principles but differ in their specification and enforceable by the profession.

2.2 Auditor's Professional Responsibilities

The U.S. Government Accountability Office (U.S.GAO) publicized through internet that preparation of financial reports is the responsibilities of the auditee entity not the auditor. Thus, Officials of the audited entity entrusted with handling public and private resources and auditors of government programs or entity fulfill essential roles and responsibilities in ensuring that public resources are used efficiently, economically, effectively, and legally. Audit organizations also have the important responsibility of ensuring that auditors can meet their responsibilities. These unique roles involve using sound management practices and providing professional audits and attestation engagements. (Internet sources: U.S GAO)

The management's of the audited entity (for example, managers of a state or local governmental entity or a nonprofit entity that receives federal awards) are responsible for

- applying those resources efficiently, economically, effectively, and legally to achieve the purposes for which the resources were furnished or the program was established;
- complying with applicable laws and regulations, including identifying the requirements with which the entity and the official must comply and implementing systems designed to achieve that compliance;

- establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; resources are used efficiently, economically, and effectively, and are safeguarded; laws and regulations are followed; and reliable data are obtained, maintained, and fairly disclosed;
- providing appropriate reports to those who oversee their actions and to the public in order to be accountable for the resources used to carry out government programs and the results of these programs;
- addressing the findings and recommendations of auditors, and for establishing and maintaining a process to track the status of such findings and recommendations; and
- following sound procurement practices when contracting for audits and attestation engagements, including ensuring procedures are in place for monitoring contract performance. The objectives and scope of the audit or attestation engagement need to be made clear. In addition to price, other factors that may be considered in evaluating bid proposals include the responsiveness of the bidder to the request for proposal; the prior performance and experience of the bidder; the availability of the bidder's staff who have the appropriate professional qualifications and technical abilities; and the results of the bidder's peer reviews. (Internet source: U.S GAO)

Also as explained by the U.S Government Accountability Office, the following are the auditors' Responsibilities:

- In discharging their professional responsibilities, auditors need to observe the principles of serving the public interest and maintaining the highest degree of integrity, objectivity, and independence. The public interest is defined as the collective well-being of the community of people and entities the auditors serve. These principles are fundamental to the responsibilities of auditors.
- Auditors should act in a way that will serve the public interest, honor the public trust, and uphold their professionalism. A distinguishing mark of a profession is acceptance of its responsibility to the public. This responsibility is critical when auditing in the government environment. GAAS embody the concept of accountability, which is fundamental to serving the public interest.
- Auditors need to make decisions that are consistent with the public interest in the program or activity under audit. In discharging their professional responsibilities, auditors may encounter conflicting pressures from management of the audited entity, various levels of government, and others who rely on the objectivity and independence of the auditors. In resolving those conflicts, auditors are responsible for acting with integrity, guided by the precept that when auditors fulfill their responsibilities to the public, these individuals' and organizations' interests are best served.
- To maintain and broaden public confidence, auditors need to perform all professional responsibilities with the highest degree of integrity.

Auditors need to be professional, objective, fact-based, nonpartisan, and non-ideological in their relationships with audited entities and users of the auditors' reports. Auditors should be honest and candid with the audited entity and users of the auditors' work in the conduct of their work, within the constraints of the audited entity's confidentiality laws, rules, or policies. Auditors need to be prudent in the use of information acquired in the course of their duties. They should not use such information for any personal gain or in any manner that would be detrimental to the legitimate and ethical objectives of the audited entity.

- Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle. Integrity requires auditors to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment. Integrity also requires auditors to observe the principles of objectivity and independence.
- Auditors should be objective and free of conflicts of interest in discharging their professional responsibilities. Auditors are also responsible for being independent in fact and appearance when providing audit and attestation services. Objectivity is a state of mind that requires auditors to be impartial, intellectually honest, and free

of conflicts of interest. Independence precludes relationships that may in fact or appearance impair auditors' objectivity in performing the audit or attestation engagement. The maintenance of objectivity and independence requires continuing assessment of relationships with the audited entities in the context of the auditors' responsibility to the public.

- In applying GAAS, auditors are responsible for using professional judgment when establishing scope and methodologies for their work, determining the tests and procedures to be performed, conducting the work, and reporting the results. Auditors need to maintain integrity and objectivity when doing their work to make decisions that are consistent with the broader public interest in the program or activity under review. When reporting on the results of their work, auditors are responsible for disclosing all material or significant facts known to them which, if not disclosed, could mislead knowledgeable users, misrepresent the results, or conceal improper or unlawful practices.
- Auditors are responsible for helping management and other report users understand the auditors' responsibilities under GAAS and other audit or attestation coverage required by law or regulation. To help managers and other report users understand an engagement's objectives, time frames, and data needs, auditors need to communicate information concerning planning, conduct, and reporting of the engagement to the parties involved during the

planning stages of the audit or attestation engagement. (Internet source: U.S GAO)

On the other hand, as per U.S Government Accountability Office internet source audit organizations'(auditors) have responsibility for ensuring that (1) independence and objectivity are maintained in all phases of the assignment, (2) professional judgment is used in planning and performing the work and in reporting the results, (3) the work is performed by personnel who are professionally competent and collectively have the necessary skills and knowledge, and (4) an independent peer review is periodically performed resulting in an opinion issued as to whether an audit organization's system of quality control is designed and being complied with to provide reasonable assurance of conforming with professional standards.

While management is responsible for addressing audit and attestation engagement findings and recommendations and tracking their status of resolution, audit organizations are responsible for establishing policies and procedures for follow-up to determine whether previous significant findings and recommendations are addressed and are considered in planning future engagements. (Internet sources: U.S GAO)

Also RJ. Anderson pointed out that, auditors' professional responsibilities are governed by the rules of professional conduct whose

enforcement is handled exclusively by the local standards. Most of these rules, however, refer to the accounting and Auditing standards of the profession, which in turn influenced by the recommendations in local standards. Among the auditing recommendations, the most fundamental are GAAS. (R.J. Anderson FCA: 1984).

Some writers (Meigs, Whittigton, Megis and Lam: 1991) say, Generally Accepted Auditing Standards are authoritative rules for measuring the quality of performance. Also as per Arens and Loebbecke, the existence of GAAS is evidence that auditors are very concerned with the maintenance of a uniformly high quality of audit work by all independent public accountants. If every public accountant has adequate technical training and performs audits with skill, care, and professional judgment, the prestige of the profession will rise, and the public will attribute more and more significance to the auditors' opinion attached to financial statements. (Arens and Loebbecke: 1991)

As per the United states GAAS, the 1972 Statements on Auditing Standards No 1 (SAS-1) issued by AICPA, the auditors' professional responsibilities are based on three broad standards (Arens and Loebbccke: 1991) No.1). These are:

1. General standards :

- The examinations are to be performed by a person or group of persons having adequate technical training and proficiency as an auditor.
- In all matters relating to the assignment, independence in mental attitude is to be maintained by the auditors (s).
- Due professional care is to be exercised in the performance of the examination and the preparation of the report.

2. Standards of field work:

- The work is to be adequately planned and assistants, if any, are to be properly supervised.
- There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.
- Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

3. standards of reporting:

- The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.
- The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.

- Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
- The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion can not be expressed. When an overall opinion can not be expressed, the reason therefore should be stated. In all cases where an auditors' name is associated with financial statements, the report should contain a clear cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

Moreover, FTC Foulks lynch, ACCA paper 3.1 (Audit and Assurance service), discusses that the auditor has no responsibility for the prevention and detection of fraud and error. As a responsibility, auditor's should design audit procedures to obtain reasonable assurance that those frauds and errors which are material and might impair the truth and fairness have not occurred, or that if they have occurred they have either been corrected or properly disclosed in the financial statements.

The auditor should have a responsibility to report to the management and those charged with governance of an enterprise when the audit has brought to light any irregularities or errors. When the matter is material he/ she should ensure the management are informed promptly and that,

where appropriate, a report is made to the board of directors or the audit committee.

Auditors should report to the users of the audit report to the extent that in their opinion, the “true and fair view” or “fair presentation”, is affected. (Foulks lynch, ACCA paper 3.1: 2004).

Therefore, from the above writers' discussion it is wise to summarize that management of an entity is responsible for the efficient, economic and effective utilization of entity's resources. Besides it is the responsibility of the management preparing financial statement for easy verification. On the other hand, it is the responsibility of auditors to form an independent opinion based on audit examination and to report the findings to the users of audited financial statements. Accordingly, auditor should based on standards or principles formulated by the professional and /or regulatory body to which they are members or by which the have been regulated.

2.3 Auditors Legal Responsibilities

As some writers say, the auditor’s legal responsibility can be statutory, contractual or both. Statutory responsibility which is based on the mandatory audit requirement in the federal and local business act. Contractual responsibility drives from an agreement mutually decided up

on by the auditor and the client. Both may also agree to certain functions in addition to the statutory requirements; in such case, the auditor will be responsible to the client for both the statutory and the additional contractual requirements. Besides the auditors must be familiar with the specific act applicable to each of their clients (Megs, Whittington, Meigs, and Lam: 1987).

The auditors' statutory responsibilities and company or national legislation consist of the general duty that auditors have to report to users on whether the financial statements of the company show a 'true and fair view' or 'present fairly' the financial position and results of its operations. Specific duties such as to consider whether the information in the management report is consistent with the financial statements and whether proper accounting records have been kept by the company were also considered as stippled in statutory requirements. (Foulks Lynch: 2004).

As per RJ Anderson, (RJ Anderson FCA, 1984), legal responsibilities of the external auditor arise from one or more of statutes, as interpreted by common law; contract, as governed by common law; and tort, as governed by common law.

From the above discussions, the researcher concludes that auditor is legally responsible for both contractual agreement made between the auditor and the client; and statutory audit requirements.

2.4 Auditors Legal Liability

In our environment, investors and creditors who suffer from financial reversals find auditors, as well as lawyers and corporate directors, tempting targets for lawsuits alleging professional malpractice. Auditors must approach every engagement with the prospect that they may be required to defend their work in court. Even if the court finds in favor of auditors, the cost of defending a legal action can be very substantial. As a result, the cost of professional liability insurance has escalated greatly. (Meigs, Whittington, Meigs and Lam: 1987)

Accordingly, costs are not the only concern, lawsuits can be extremely damaging to a professional's reputation. In extreme cases, the auditors may even be tried criminally for malpractice. Hence, auditors are legally liable to their clients and to third parties who rely upon audited financial statements.

As Foulks lynch (Foulks lynch: 2004) says, statutory responsibilities impose liabilities if things go wrong. Auditor liability in most countries can be categorized as liability under legislation either civil or criminal in

those countries with civil code legal traditions and liability arising from negligence under common law in those countries with common law legal traditions.

The civil code of many countries makes director or others responsible for a company liable for fines and other penalties for:

- failing to properly prepare and deliver financial statements to the relevant authorities within the given time period.
- failing to provide auditors with access to the books, records and necessary information and explanation for the purpose of the audit.
- failing to keep proper books account.
- failing to appoint auditors.

On the other hand, auditors may be liable in the following circumstances;

- to third parties suffering loss as a result of relying on a negligently prepared audit report,
- under insolvency legislation to creditors,
- under fiscal legislation (such as tax fraud)
- under financial services legislation to investors,
- Under stock exchange legislation and / or rules.

Criminal liability can arise in the following circumstances;

- It is always an offence to accept an appointment as auditor when ineligible to do so or to continue in office after becoming ineligible.
- It may be criminal offence to misappropriate others property, obtain a financial advantage by deception, falsify accounting records or documents, publish a misleading statement intended to deceive members or creditors.

Foulks lynch also stated that, the company has a contract with the auditors, and hence can sue the auditor for breach of contract if the auditor simply fails to deliver an audit report, or delivers a negligently prepared audit report. In countries with common law legal traditions, the auditor may be liable to shareholders and others who have relied on the financial statement up on which he expressed an opinion, under the general principle of owing a duty of care to those parties and being liable in the tort of negligence if he fails in that duty.

A third party (i.e. a person who has no contractual relationship with the auditor) may also sue the auditor for damages', i.e. a financial award- which is liability in tort. Writers also pointed out (Meigs Whittington, Meigs and Lam 1987) auditors are liable to their clients when failed to exercise due professional care. This obligation exists whether or not it is specifically set forth in the written contract with the client. Thus, private

auditors are liable to their clients under common law for any losses proximately caused by the auditors' failure to exercise due professional care. That is, to cover its loss an injured client need only prove that the auditors were guilty of negligence and that the auditor's negligence has the proximate cause of the client's losses.

The liability of private auditing firms to third parties not in practice has developed under the common law. The responsibilities of auditors to third parties who may rely on the auditors report has evolved through several significant court cases. These cases involve the auditors' liability to third parties for negligence, gross negligence and fraud. Negligence is failure to perform an audit in accordance with applicable professional standards. Substantial failures on the part of an auditor to comply with generally accepted auditing standards might be interpreted as gross negligence. Fraud is misrepresentation by a person of a material fact, known by that person to be untrue or made with reckless indifference as to whether the fact is true, with the intention of deceiving the other party and with the result that the other party is injured (Meigs, Whittington, Meigs And Lam: 1987).

As per RJ Anderson (RJ Anderson FCA 1984) private auditors become legally liable to certain parties, if they fail to discharge statutory responsibilities, contractual responsibilities and responsibilities in tort.

The majority of errors which expose a private auditor to legal liability fall under the law of torts and specifically the tort of negligent misrepresentation. Negligence results from the failure to perform a legal duty or the failure to perform that duty with the requisite standard of care.

Whether the duty is statutory, contractual or one in tort may affect the technical nature of the action brought against auditor. An action for negligence brought by third parties will generally be an action in tort whereas one brought by the auditor's client will generally be for breach of contract (RJ Anderson FCA: 1984).

Some writers argued that, litigation has had a significant impact on the public accounting profession and it seems reasonable to expect that it will continue to do so in the foreseeable future. To avoid litigation, it is vital that the auditor comply fully with professional pronouncements in completing each audit engagement and use sound professional judgment during the audit and at the time of issuing the audit report. The issue of auditor liability is very much an unresolved matter. Auditors are liable under statute to their clients for breach of duty under corporations' law. However, the interpretation of the law has been largely dependent on court cases. (Gill, Cosserrat, Leung & Coram: 1999)

As per Grant Gay & Roger Simnett, the auditor duty of care to a client arises both in contract and in tort of negligence. If the auditor has been negligent, the clients may sue the auditor for breach of the implicit term of the contract, and recover any consequential loss suffered. Alternatively, the client may sue the auditor in the tort of negligence to obtain damages sufficient to restore the client to its original position. Moreover, the situation of the auditor's liability in relation to persons other than the immediate client has been the subject of much litigation. Third parties who rely on an auditor's opinion, and suffer a loss caused by the negligence of the auditor, have no contractual claim for recovery of losses. An injured third party can, however, bring an action in tort, which is a civil wrong compensated by an award for damages. A right of action tort depends on whether an interest protected by law has been injured (Grant Gay & Roger Simnett).

Therefore, the researcher summarizes the above writers' discussions, as that auditor should be legally liable for violation of contractual, statutory and/or both. Thus, an auditor should be liable to the client for violation of both contractual agreement and statutory audit requirements. Moreover, the auditor should be liable to third party who suffers a financial loss as a result of miss stated audit report, which is a liability in tort.

CHAPTER THREE

PRIVATE AUDITORS PROFESSIONAL RESPONSIBILITIES AND LEGAL LIABILITY: THE CASE OF ETHIOPIA

Auditing Standards are the criteria or yardstick against which the qualities of audit results are evaluated. They provide minimum guidance for the auditor that helps to determine the extent of auditing steps and procedures that should be applied in the audit work.

Similarly, the Ethiopian Government Auditing Standards stated that the statement of auditing standards describes the basic principles which govern the auditor's professional responsibilities and which must be complied with whenever an audit is carried out. It provides a framework with in which professional judgment must be exercised and establish the minimum standard to be followed on individual audits.(OFAG: Ethiopian Government Auditing Standards : 2004)

Due to absence of a well organized and empowered professional accounting and auditing body in Ethiopia at the present time, there are no formalized professional standards issued by any authority in the country. However, OFAG have adopted minimum auditing standards incorporated in their respective audit standards which it has developed.

The task of preparing detailed ethical principles and rules is primarily that of the professional associations and that all members of the associations have the responsibilities to accept, implement and enforce such requirements. In Ethiopia, due to the absence of an organized strong national professional association there is no comprehensive set of ethical standards to govern the behaviors of professional accountants. In the case of authorized auditors, it is assumed that they adhere to the code of ethics set by the professional bodies to which they are members. (OFAG: 2004).

Therefore, this chapter of the project paper is going to explore the Ethiopian private auditors' practices in applying auditing standards established by professional body to which they are members; the code of ethics applicable to them, and the major legal concepts that relate auditors' liability to clients and third parties under common law.

3.1 Ethiopian Government Auditing Standards

The purpose of auditing standards is to establish standards and provide guidance on the objective and principles governing an audit of financial statements. The objective of audit of financial statements is to enable auditors to give an opinion on those financial statements taken as a whole and thereby to provide reasonable assurance that the financial

statements give a true and fair view and have been prepared in accordance with relevant accounting standards or other requirements.

The auditing standards adapted by OFAG have classification as General standards, fieldwork standards, and reporting standards. These standards are adopted from International Federation of Accountants (IFAC), UK and AICPA.

In this regard Johannes summarized that in underdeveloped countries like Ethiopia, the development of public accounting profession cannot be left or be waited upon to develop by itself voluntarily in a self-regulated manner as in those advanced countries as England and America. A deliberate attempt instead must be made through legislation to establish, develop, and regulate public accounting profession despite the disadvantages that may loom in developing an accounting profession by legislation (Johannes; 1970).

Therefore, from the above discussion it is wise to conclude that for the accounting profession to be well developed all the concerned body including the audit organization should regulate and monitor the auditing activities in one way or another.

3.1.1 General Standards

According to Ethiopian government auditing standards document issued by office of the Auditor General (OFAG:2002) the general standards includes the auditors independence in all aspects from the client, auditor's professional competence, exercising due professional care, audit quality control by both the auditor's and client, audit engagement letter requirement (commercial perspective), subsequent events to audited financial statement (commercial perspective) and going concern requirement (commercial perspective).

3.1.2 Fieldwork Standards

Office of the Auditor General (OFAG: 2002) also discloses fieldwork related standards, which are the responsibility of the auditor's. These include planning the audit, Knowledge of the entity, materiality of the information to be disclosed, accounting and internal control systems requirement, audit sampling requirement, supervision and review of the work of field auditors by senior auditors, fraud and error detection requirement, compliance with applicable laws and regulations, audit evidence gathering, audit of accounting estimates requirement, obtaining management representations, opening balances and comparatives discloser, discloser of related parties information (commercial perspective), considering the work of internal audit, using the work of an

expert, the relationship between principal auditor and other auditor, and working paper importance and its ownership.

3.1.3 Reporting Standards

According to the document issued by office of the auditor General (OFAG: 2002), the reporting standards involve the report format, report contents, report presentation, timeliness of the report, report distribution, and the importance of the report to management.

From the above discussions it is wise to conclude that the auditing standards adopted from the international standards are the guidelines to be followed by the auditors. Moreover, these standards are adopted from CPA and ACCA standards.

3.2 Code of Ethics Applicable to Authorized Auditors

As stated on the OFAG code of Ethics for authorized auditors (2004), most authorized auditors and accountants perform their duties and responsibilities in accordance with the professional standards and ethical requirements developed by OFAG in the past. However, clients and their parties have been complaining against some authorized auditors and accountants regarding the unethical actions done by the practicing auditors and accountants.

Therefore, for these reasons, OFAG established a revised code of Ethics for authorized auditors to be used as a basis in discharging their professional duties to the public, as follows:

Independence: a professional accountant, member of assurance teams and firms should be independent in the performance of professional services for the client. Independence requires the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism. Besides it requires that avoidance of facts and circumstances that are so significant that a reasonable and informed third party, including safeguards applied, would reasonably conclude a firm's or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

Professional competence and Responsibilities regarding the use of

Non-accountants: professional accountants should refrain from agreeing to perform professional services which they are not competent to carry out unless competent advice and assistance is obtained so as to enable them to satisfactorily perform such services. If a professional accountant does not have the competence to perform a specific part of the professional service, technical advice may be sought from experts such

as other professional accountants, lawyers, actuaries, engineers, geologists, and values.

Fees and commissions: professional accountants, who undertake professional services for a client, assume the responsibility to perform such services with integrity and objectivity and in accordance with the appropriate technical standards. That responsibility is discharged by applying the professional skill and knowledge which professional accountants have acquired through training and experience. For the service rendered, the professional accountant is entitled to remuneration.

Professional fees should be a fair reflection of the value of the professional services performed for the client, taking in to account the skill and knowledge required the level of training and experience, the time necessary occupied by each person and the degree of responsibility.

A professional accountant should not pay a commission to obtain client nor should a commission be accepted for referral of a client to a third party. A professional accountant should not accept a commission for the referral of the products or services of others.

Activities incompatible with the practice of public accountancy: A professional accountant should not concurrently engage in any business,

occupation or activity that impairs or might impair integrity, objectivity or independence, or the good reputation of the profession and therefore would be incompatible with the rendering of professional services.

The rendering two or more professionals services concurrently does not by itself impair integrity, objectivity or independence, but regarded as inconsistent with the practice of public accountancy.

Relations with other professional accountants: Professional accountants should only accept new assignments which they can expect to complete with professional competence. It is essential therefore for the profession in general and in the interests of their clients that professional accountants be encouraged to obtain advice when appropriate from those who are competent to provide it.

Besides the proprietors of a business have an independent right to choose their professional advices and to change to others should they so desire. While it is essential that the legitimate interests of the proprietors be protected, it is also important that a professional accountant who is asked to replace another professional accountant has the opportunity to ascertain if there are any professional reasons why the appointment should not be accepted. This can not effectively be done without direct communication with the existing accountant. In the absence of a specific

request, the existing accountant should not volunteer information about the client's affairs.

Advertising and solicitation: advertising and solicitation should be aimed at informing the public in an objective manner and should be decent, honest, truthful, and in good taste. Solicitation by the use of coercion or harassment should be prohibited.

It is clearly desirable that the public should be aware of the range of services available from a professional accountant.

Accordingly, there is no objection to a member body communicating such information to the public on an institutional basis, i.e., in the name of the member body.

Hence, it is wise to conclude from the above that Ethiopia private auditors should have a responsibility to follow those fundamental principles. Thus, these fundamental principles are the guidelines to regulate the practice of the auditors.

3.3 Legal Responsibilities and Liability

Authorized auditors and accountants have an important role in society. Investors, creditors, employees and other sectors of the business community as well as the government and the public at large rely on professional accountants for sound financial accounting and reporting,

effective financial management and competent advice on a variety of business and taxation matters. The attitude and behavior of professional accountants in providing such services have an impact on the economic well being of the community.

Therefore, they should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism (OFAG: 2004).

Article 374 of the commercial code of Ethiopia states that the auditors shall have duties or responsibilities:

- To audit the books and securities of the company
- To verify the correctness and accuracy of the inventories, balance sheets and profit and loss accounts,
- To certify that the report of the board and directors reflects the correct state of the company's affairs,
- To carry out such special duties as may be assigned to them

Also the auditors have a legal responsibility to submit to the annual general meeting a written report to board of directors. (Commercial code of Ethiopia Art. 375)

Besides as stated on commercial code Art. 376 sub 1, auditors are legal responsible to inform directors irregularities. Thus where the auditors find irregularities or breaches of legal or statutory requirements, they shall inform the directors and, where grave irregularities or breaches

have occurred, they shall inform the general meeting. (Art 376 of commercial code of Ethiopia).

On the other hand, auditors are legally liable for violation of professional responsibilities and legal responsibilities. Supporting this, Art 380 of commercial code of Ethiopia, state that auditors shall be civilly liable to the company and third parties for any fault in the exercise of their duties which occasioned loss. Besides an auditor who knowingly gives, or confirms an untrue report concerning the position of a company or fails to inform the public prosecutor of an offence which he known to have been committed shall be punished under Art. 438 or Art. 664 of penal code as the case may be.

Of course, as stated on the commercial code of Ethiopia, Art 373, Auditors shall be liable to penalties prescribed in Art 407 of the penal code for breaches of professional secrecy, i.e. professional and legal responsibilities.

Therefore, the researcher concludes from the above that private auditors should strictly follow that code of ethics formulated by OFAG and the commercial code of Ethiopia 1960 in examining entities books of accounts as well as in reporting to the users audited financial statements. Thus, failure to comply with these regulations has legal liability to their clients and the law of the land.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

This part of the project paper is designed to address the extent to which private auditors exercise their professional and legal responsibilities, and the extent to which the client prepare financial statements for easy verification. Moreover, it designed to explore the responsibility of directors (management) and auditors with regard to financial statements and subsequent to the discovery of misstatements to audited financial statement. Also tries to examine the extent to which private auditors are subject to legal liability for committing illegal audit practices, and the constraints that exist on private auditors in attempting to exercise their responsibility.

For the fulfillment of the above objective the student researcher has purposively sampled fifteen organizations managers in order to respond the research questioner. However, only eleven managers' successfully answered the questioner. The personal data of the managers (respondents) and characteristics of the organizations are presented in annexes respectively by table 1, and table 2.

As observed from the responses obtained the majority of the respondents are male, 73.33%, and all are Ethiopians. More than 75% of the respondents hold B.A/B.Sc and above (see table one from the annex).

Of the total responding organizations the majorities are characterized as private limited companies, 54.55%, and about 18.18% are non-governmental organizations (NGOs). Also most of the organizations of the respondents are merchandising business, 45.46%, and only 9.09% from construction type businesses. Most of them aged more than 5 years on average, 72.72%. The annual profit of the respondent organization mostly between Birr 50,000 to birr 100,000. None of the respondent's organizations has a subsidiary or branch from abroad (see table two from the annex).

On the other hand, the researcher planned to interview seven audit firms' managers. However, only six of them, 85.71%, were available for the interview, all of who have Ethiopian nationality and male. All of the interviewed firms are companies, which were established before 10 years on average.

4.1 Responses from Clients and Auditor’s concerning as to what Extent Ethiopian Private Auditors are Exercising Professional and Legal Responsibilities

4.1.1 Independence

The survey was conducted in order to assess the auditor’s independence in exercising professional responsibilities. Thus, in all matters relating to the audit work, the audit organization and the individual auditors, whether government or public should have an adequate degree of independence from the legislature and should be free from executive and audited entity and should maintain an independent attitude in fact and appearance. The survey result concerning to independence is as follows:

Table 1: Clients response on auditor’s independence:

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
When conducting and audit, do you think that your auditor independent from you in all aspects?	7	63.64	4	36.36	11	100

As shown above, seven (63.64%) of the clients responded that private auditors were independent in all aspects from the influence of audit organization in relation to the audit work. However, a considerable number (36.36%) confirmed that private auditors were not independent.

On the other hand, the majority (57.14%) of the interviewee responded as those in all aspects private auditors were independent of their clients. But, the remaining 42.86% said that most of the time private auditors loss independence in terms of soliciting clients, negotiating audit fee, and giving an opinion.

As stated on the article of Tesfaye Mengasha, on capital weekly news letter," bidding/tendering may sometimes result in saving in audit fees. Should this be the primary concern of the government? Audit fee levels were recovered to be the lowest even by African standards, before the tendering/bidding systems came about. What if such reductions in fees are achieved at the expense of the quality/effectiveness of the independent audit, which is the "raison-d'etre" of the entire exercise? When the tax collection role of the government is considered, the quality of the audit, as a reliable source of information, becomes even more important, relative to the required audit fees. Having said this, one must be wary of the limitations of an audit with the possibility of expectation gaps being created. Financial statement audits are sample based. Clear

distinction should be made between tax evasion, an illegal practice, and tax avoidance scheme, which should be regarded as quite legitimate. Not everyone is an angel in as much as not everyone Satan. Any audit has its own start up costs to the auditor concerned. Far too frequent changes in auditors, following the mechanical bidding/tendering system, also break continuity and familiarity with the assignment. As a result, the auditors' independence could be impaired". (Capital: 2003)

From the above over all analysis of the data the researcher concluded that although it is said that private auditors were independent in their audit work there could an occasion where private auditors by force or interest can violate the principle of auditor's independence from their clients in conducting an audit work. Moreover, it is wise to conclude from the above mentioned article that as a result of tendering/bidding nature the auditors' independence could be compromised.

4.1.2 Competence

The audit organization needs to command the range of skills and experience necessary for effective discharge of the audit mandate. Whatever the nature of the audit to be undertaken under that mandate, persons whose education and experience is commensurate with the

nature, scope and complexities of the audit task should carry out the audit work. The survey result is shown in this regard as follows:

Table 2: Clients response on auditor’s competence:

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Is there a moment you faced that your auditor is not professionally trained and competent?	3	27.27	8	72.73	11	100

As depicted by table 2, 72.73% of the respondents showed that auditors were professionally skilled, trained and competent in order to carry out their professional responsibilities. On the other hand all the interview responses revealed that most of the time individual auditors hold B.A degree and above in accounting profession in order to perform audit work. 27.27% of the respondents, however, claimed that some times less qualified and incompetent field auditors were coming to their organization. Thus, the data implied that most private auditors were professionally trained and competent.

4.1.3 Audit Work Plan and Supervision

The auditor should plan the audit work in a manner which ensures that an audit of high quality is carried out in on time, an economic, efficient and effective way. On top of this, proper supervision and control is therefore necessary in all cases regardless of the competence of individual auditors as is shown in the table blow:

Table 3: Clients response on audit work plan and field work supervision:

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Do you think that your auditor is adequately planning and frequently supervising the work of field auditors?	9	81.82	2	18.18	11	100

The majority of the respondents, (81.82%) agreed that private auditors properly planned their work and the senior auditors frequently supervise field auditors. Similarly, all of the interview responses depicted the same conclusion.

Hence, the analysis of the overall data shows that private auditors adequately plan their audit work and frequently supervise the work of field auditors.

4.1.4 Due Professional Care

The student researcher also tried to identify whether the auditor exercise due professional care or not. Thus, the auditor and the audit organization must exercise due care and concern in complying with the auditing standards. This embraces due care in specifying, gathering and evaluating evidence, and in reporting findings, conclusions and recommendations. In this regard the survey result showed the following:

Table 4: Clients response on auditor’s due professional care exercise:

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Do you think that all auditing processes need due professional care?	11	100	0	0	11	100

Accordingly, as shown in table 4 above and data obtained from interview result, both the clients and private auditors agreed that all auditing processes need exercising of due professional care. Thus, both

preparation of financial statements, which is the responsibility of the management of the client; and examination of the financial statements, which is the responsibility of the auditor's need exercising due professional care.

4.1.5 Internal Control Structure

The study also tried to clarify whether private auditors examine the internal control structure of an audit entity. Thus, as it was obtained from the clients' responses (see table below) most of them, (63.64%), agreed that auditors examine the internal control structure of an audit organization. Moreover, the clients' respondents added that examination of internal control structure of the client help the auditor for gathering efficient competent evidential information to express an opinion.

Table 5: Clients response on internal control structure

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Is your auditor examines the internal control structure of your organization?	7	63.64	4	36.36	11	100

Similarly, 85.71% of the interviewee agreed that examining the internal control structure of an organization under audit helps to evaluate the extent of sampling, tests of the documents in order to gather sufficient evidential matter to express an opinion.

From the above, the student researcher conclude that examination or evaluation of client internal control system helps the auditor in gathering the important information for the expression of an opinion.

4.1.6 Evidence

The researcher also administers an interview in order to obtain data to identify how the auditors obtain sufficient evidential matters in order to express an opinion. Accordingly, the majority of the interviewee (85.71%) responded that such information were obtained through inspection, observation, inquires, and circulating confirmations to serve as a reasonable basis for an opinion.

The researcher concludes from the above that private auditor were properly planning and performing the audit so as to obtain sufficient evidence to give reasonable assurance that the financial statements of the client are free from material misstatements.

4.1.7 Reporting Standards

The auditors should follow reporting standards while preparing a report for the users. The reporting standards demand that the report shall state whether financial statements are presented in accordance with generally accepted accounting principles; whether such principles have been consistently applied in the current period in relation to the previous period; adequate information disclosure to the users of the report; and an expression of an opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion can not expressed.

Table 6: Clients response on consistent application of GAAP

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Is there a moment you base on principles other than GAAP?	0	0	11	100	11	100

Accordingly, the result of the survey (see table 6) revealed that, all the client respondents responded that, the generally accepted accounting principle are applied in the preparation of the financial statements. Moreover, GAAP has been applied consistently, as the entire client replied. All the interviewee responses showed that clients had been consistently following GAAP, though there were circumstances that lead

the financial statements to opinion other than unqualified one. However regarding the application of GAAP the student researcher in his five years auditing experience observed that organization, like NGOs, were not applying GAAP. But the interviewed auditors and those NGOs managers respondents were not honest to disclose the fact. They further added that sometimes when such things arise the clients request other opinion, qualified opinion when the opinion goes to either of adverse or disclaimer one.

Table 7: clients' response on materiality principle

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Do you think that materiality principle used as a base in disclosing an error obtained during an audit examination?	8	72.73	3	27.27	11	100

The survey result also showed (see table 7) that eight (72.73%) of the client respondents confirmed that auditors follow the materiality of information in disclosing to the users of the report. However, the remaining clients respondents (27.27%) showed that auditors were disclosing all information obtained, regardless of its materiality to the users of audited financial statements.

On the other hand, the interview response showed that even though the error obtained was immaterial, the long run effect of the information on the going concern was taken in to account to disclose in the report. But they added that such immaterial information was reported on the management letter for internal control purpose and in order to eliminate the long run effect of it.

In this regard Tesfaye Mengasha articulated on Capital weekly news letter dated 13 July 2003 supporting his another article on the same news letter dated 6 July 2003, "some of us might find it difficult to imagine as to how the same Bank with two different auditors could arrive at two different results using numbers, which we normally understand them to be precise. Unfortunately, accounting is full of estimates. An audit is simply an exercise of professional judgment. Both the international and local auditors are entitled to their own opinion. However, to me as an outsider now, divergence of this magnitude can not be easily accommodated within the spectrum of "opinion" difference of course assuming the two exercises to be similar in scope". (Capital: 2003).

This shows that, though the auditing standards applicable by both international and local auditors is the same there could be an occasion that auditors compromise professional responsibility.

From the above analysis and discussions, the student researcher concludes that there is a circumstance where the auditors are negotiating with their client to change the opinion.

4.1.8 Contractual Agreement

The second part of this section deals with the auditors legal responsibilities with regard to examination of the financial statements of the audit client's from the point of view of both clients and auditors. In this regard the student researcher attempted to assess the issues as follows:

Table 8: Signing contractual agreement before the starting the audit:

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
When your business is audited, are you signing a contract or an agreement with your auditor?	8	72.73	3	27.27	11	100

As indicated in table 8, of the total client respondents, eight of them, (72.73%), replied that once the auditor is assigned or selected, the next step is signing contractual agreement consisting of the scope of the

audit, the qualification of the auditor’s staff to be involved in the audit task, duration of the audit work, responsibility of the management and the auditors, audit fee and others. Similarly, all the interviewed auditors responded that it is mandatory to sign contractual agreement consisting the scope of the audit, the qualification of the auditor staff to be involved in the audit task, duration of the audit work, responsibility of the management and the auditors, audit fee and others before starting the audit.

From these the researcher can conclude that businesses sign contractual agreement with auditors before start auditing the books of accounts.

4.1.9 Contractual Obligation

Table 9: Clients response on auditor’s contractual responsibility:

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Do you think that private auditor is liable for violation of contractual responsibility?	11	100	0	0	11	100

As it is depicted in the above table all the respondents, 100%, confirmed that auditors are responsible for contractual agreements made between

the client and the auditor. Moreover, the respondents confirmed that, auditors who violate a contractual agreement are made legally liable to the client and the law of the land.

On the other hand as determined from the interview result, private auditors have the responsibility to follow contractual agreement signed between the two parties in conducting audit work.

Thus, from the analysis of data on auditor's contractual responsibility, it is possible to infer that private auditors are made liable for violation of contractual responsibility.

4.1.10 Statutory Obligation

As stated on Art. 380 of commercial code of Ethiopia, auditors shall be civilly liable to the company and third parties for any fault in the exercise of their duties which occasioned loss. Besides, an auditor who knowingly gives, or confirms an untrue report concerning the position of a company or fails to inform the public prosecutor of an offence which he known to have been committed shall be punished under Art. 438 or Art. 664 of penal code as the case may be. The survey result in this regard is as follow:

Table 10: Clients response on auditor’s statutory responsibility

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Are private auditors liable for violation of statutory responsibility?	11	100	0	0	11	100

As it is depicted in the above table, all the respondents (100%) confessed that, auditors are responsible for statutory audit requirements. Moreover, the respondents confirmed that, auditors who violate statutory responsibility are legally liable for both to their client and a third party.

On the other hand, as examined from the interview result, private auditors have the responsibility to follow statutory audit requirements when conducting audit work and made liable for the violation of those responsibilities.

In general, from the overall analysis of the data, it is possible to conclude that private auditors are liable for violation of statutory responsibility.

4.2 The responsibilities of management and auditors with regard to the financial statements and subsequent to the discovery of misstatements to the financial statements

In order to identify the responsibilities of the management from the auditor with regard to preparation of financial statements and subsequently discovery of misstatements to the audited financial statements the student researcher explore the following results:

4.2.1 Preparation of Financial Statements:

Table 11: Clients' response on preparation of financial statements:

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Is there an occasion where you invited your auditor for financial statements preparation?	0	0	11	100	11	100

As it is depicted in the table, all the respondents (100%), agreed that preparation of financial statements is the responsibility of the management of the client organization. Accordingly, the interview result revealed that, all the interviewee responded as that, preparation of

financial statements is the responsibility of the management, whereas it is the responsibility of the auditor's to express an opinion whether the financial statements produced presents the "true and fair view" of the entity.

From the above analysis, it is wise to conclude that preparation of financial statements is that of the client where as the auditors responsibility is examining financial statements produced by their client.

4.2.2 Misstatement of Audited Financial Statements

Table 12: Clients' response on subsequently discovery of misstatements to audit financial statements:

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
Do you think that private auditors legally liable, for subsequently discovery of misstated audited financial statements?	11	100	0	0	11	100

As depicted by the above table, the entire respondent (100%) agreed that private auditors are legally liable for subsequently discovery of misstatement audited financial statements. Similarly, all the interview respondents showed agreement to the same conclusion. However the interviewee argued that this hold true only if the auditor expressed inappropriate opinion.

From the above discussions the student researcher concludes that the auditors not liable for subsequently discovered misstated audited financial statements if their opinion was qualified for these effects.

4.3 Responses of the Audit Organization with Regard to Auditor's rules of Professional Ethics

Advertising and solicitation should be aimed at informing the public in an objective manner and should be decent, honest, truthful, and in good taste. Solicitation by the use of coercion or harassment should be prohibited.

Supporting the above Jack C. Robertson (1990) argued that professional ethics for accountants is not simply a matter covered by a few rules in a formal code of professional conduct. Concepts of [proper professional conduct permeate all areas of practice. Ethics and its accompanying

disciplinary potential are the foundation for public accountants self regulatory efforts (Jack C. Robertson: 1990). The survey result in this regard showed the following:

4.3.1 Selection of Auditors

Table 13: Auditors selection criteria:

What are your criteria when selecting an auditor?	Response	
	Number	%
Through advertisement on media	5	45.46
By family or friend relationship	4	36.36
The controlling part can assign	2	18.18
Other	0	0
Total	11	100

As shown above in table 13, most of the respondents, 45.46% indicated that auditor's selection is made mostly through advertisement. However, a reasonable number of the respondents (36.36%) claimed that selection is also made on family or friendship basis. On the other hand the result of the interview showed that audit task is obtained through advertisement made by client, it can be by family or friend relationship, it can be by assignment by the controlling party. But assignment is only for those organizations under the control of privatization agency.

Therefore, from the analysis of responses, it is safe to infer that, although advertisement is mostly used for auditor’s selection, family or friendship based selection is also made.

4.3.2 Purpose of Audit Report

In order to make rational investment, credit rating, business expansion and others decisions, decision makers rely on the financial information of business entities. The decision makers are more confident when such financial information is examined by independent professional accountants. From the above perspective, the survey tried to look at the following questions:

Table 14: The purpose of audit report:

For what purpose is your business audited?	Response	
	Number	%
For taxation purpose	4	36.36
For creditors or others external users	5	45.46
Auditing the books of accounts is mandatory	2	18.18
Total	11	100

As shown by the above response result, 45.46% of the respondents agreed that the purpose of auditing books of accounts is in order to satisfy the creditors in making decisions regarding loan, trade on accounts and others. On the other hand while 36.36% of the respondents argued that the purpose for audit report is for taxation purpose, only 18.18% replied that it is mandatory to audit books of accounts.

Hence, from the above analysis it is possible to conclude that most clients lack understanding about the purpose of auditing because most clients confirmed that the purpose of auditing the books of account is for creditors or other external users.

4.4 Constraints to Private Auditors in Attempting to Exercise their Responsibility

As stated in the review of literature part of the study, in order to make rational business decisions, investors, creditors, managers, shareholders of a business need financial information of their own as well as competitors. Accordingly, in order to be confident in making decision they base their decision on audited financial statements. Therefore, it is the responsibility of auditors to disclose information shown on the financial statements to the users of audited financial statements.

However, there are constraints on auditors in attempting to exercise their responsibilities. Thus, as determined from the survey questionnaire and interview result, auditors are subject but not limited to the following constraints:

1. As determined from the survey result shown below, most of the time the clients demand unqualified opinion.

Item	Response					
	Yes		No		Total	
	No	%	No	%	No	%
When your auditor is examining your books of accounts, do you expect an opinion other than unqualified one?	4	36.36	7	63.64	11	100

Similarly, the interview responses showed that all the time audit organizations demand unqualified opinion when the opinion goes to qualified or disclaimer or adverse one. Also as examined from the interview response sometimes there is a loss of client when the opinion goes too qualified or disclaimer or adverse one.

2. As determined from the interview response analysis there has been lack of nationally organized professional body that is responsible for controlling the duties and responsibilities of auditors and to formulate

principles, standards which govern practicing accounts and auditors. They added that dependence on International Standards on Auditing there has been a time gap between the amendments of these standards and application in Ethiopia.

3. As determined from the survey result (see table 13) in some cases if not always client selection depends on family or friend relationship as a result of which violation of the professional responsibilities occurred.

4. Interview responses showed that, most of the time private organizations except share companies do not want to present real information for auditing.

5. Responses from the majority of the interviewee revealed that, one of the major constraints in the audit work is lack of demand of audit service on the part of the clients or business firms on regular basis.

4.5 Case Analysis

Although the study attempted to disclose the major problems on auditors' professional responsibilities and legal liability with regard to private auditors, due to the confidential nature of the issue under study, the data obtained from the respondents did not adequately confirm the assumed problems.

Hence, for the purpose of obtaining additional findings the following cases which were obtained from various sources are analyzed as follows.

1. The case of United Insurance S.Co and Kokeb Moges and Co.

United Insurance Company is one of Insurance Companies in the country and one of the first private insurance companies formed following financial sector liberalization in 1994. On the other hand, Kokeb Moges and Co is one of the private audit firms providing auditing service in the country.

As per the law of the country financial institutions are operating under the regulation of National Bank of Ethiopia (NBE), and Office of Auditor General is responsible to regulate private audit firms.

Accordingly, financial institutions should submit audited financial statements to NBE in order to renew their license every year.

As reported on Fortune and Reporter, weekly newsletters, dated respectively December 4 and December 31, 2005 NBE had forced the United Insurance Company to revise audit report.

As per the reported dated December 31, 2005; Kokeb Moges and Co. produced two audit reports for the same fiscal year (the year ended June

30, 2005). As per the first audit report dated September 27, 2005 the profit and loss account of the company showed profit before taxation of birr 11, 775, 769. Moreover, the Balance sheet on the same data showed debtors amounting birr 27,910,193 and investments amounting birr 20,973,737 (see annex 5 and 6).

On the other hand as per the second audit report dated November 26, 2005 profit and loss account showed a net loss of birr 960,590. Besides, the Balance sheet on the same date showed that debtors amounting birr 13, 049,236 and investments amounting birr 22, 323,737 (see annex 5).

Similarly, the auditor expressed two different opinions on the two audit report. The first opinion is unqualified, which was stated as, "In our opinion, the financial statements give a true and fair view of the state of the company's affairs as at 30 June 2005 and of its results and cash flows for the year then ended in accordance with the accounting policies adopted by the company". (See annex 6) Whereas the second opinion is qualified, which was stated as, "Except for any adjustments, which might be necessary in respect of the above matter in our opinion the financial statements give a true and fair view of the state of the company's affairs as at 30 June 2005 and of its results and cash flows for the year then ended in accordance with accounting policies adopted by the company" (see annex 5)

The difference in the two audit reports is a result of::

1. Investment worth a sum of birr 1, 350,000 six year before the audit report from which the company received no return. Also as explained in the report the going concern of the company at which such investment was made is critically questioned by the investee auditor. (see annex 5)
2. As per the first report no provision has been made for the debtors amounting birr 13,302,784.21, which was long outstanding for four years as of the balance sheet data. (see annex 5)

Moreover, as stated on fortune, dated December 4, 2005, the nature of the provision was a financial guarantee bond the united insurance S. Co issued four years ago as of the balance sheet data on behalf of its clients. (See annex 3)

Also as depicted on Fortune, the insurance companies regulatory body (NBE) introduced new debts aging instructions effective December 2002 instead of the old one. (See annex 3)

The auditor from his side also stated on the second report that “by not observing the provisions specifically mentioned under paragraph 6 above, the company has committed inappropriate accounting treatment of transactions which gives rise to an understatement of provision for

profit tax by an amount of birr 1,057,996 and profit and loss account and legal reserves respectively”

Regarding the case the researcher tried to get data from OFAG, NBE and the Auditor concerned. But all the organizations did not allow access to the right data because of the confidentially nature of the data and the final decision has not been disclosed from disciplinary committee, chaired by OFAG.

Therefore, from the above analysis in the view of the researcher possible to conclude that the auditor violated professional responsibility by not disclosing relevant information and examining the accounting policies of the company. Thus:

- The auditor did not take in to account the NBE rules and regulations when conducting an audit. Thus, the debtors aging policies of the NBE has not been considered.
- Misapplication of the accounting principle has not been disclosed.
- Provision on debtors has not been disclosed.

2. The case of HST chartered certified accountants

HST Chartered Certified Accountants is a private audit firm established in 2003 in partnership between Haileleul Tamiru, Solomon Gizaw and Tekeste Gebru with a capital of birr 300,000 having a customer base of about 200 clients. HST represents in Ethiopia, Deloitte and Touché, one of the four largest global audits and consulting firms.

Authorized auditors must conduct an audit in accordance with generally accepted auditing standards and locally formulated auditing standards, if any. Thus, they are responsible for the code of ethics established by the professional body to which they are members.

As stated on ACCA rule book, that the code of ethics and conduct establishes the ethical requirements for members. It sets out the fundamental principles and provides a conceptual framework for applying those principles. Members are required to apply this conceptual framework to identify threats to compliance with the fundamental principles, to evaluate their significance and, if such threats are other than clearly insignificant, to apply safeguards to eliminate them or reduce them to an acceptable level such that compliance with the fundamental principles is not compromised (ACCA: 2007).

Besides, OFAG stated on the code of professional ethics under the enforcement of rule of conduct that each professional accountant has the responsibility to promote the high standards of professional conduct and to ensure that ethical requirements are observed and failure to do so would be investigated and appropriate action taken (OFAG: 2004).

Moreover, the Office of Auditor General is responsible for the enforcement of the ethical requirements described in the OFAG code of Ethics (2004) and for taking appropriate disciplinary action until such time that a separate and competent body able to take on this responsibility is established by the government of Ethiopia (OFAG: 2004).

From the above it is wise to conclude that Ethiopian private auditors have a responsibility to act in accordance with the code of ethics established or formulated by, ACCA and OFAG. Violation of these codes of ethics is subject to legal liability. But as reported on the fortune, weekly news letter, dated December 10, 2006; the Auditor General has imposed the highest penalty with warning on HST because of violation of "professional behavior" one of the nine values articulated in the basic principles (see annex 7).

As reported on the newsletter, Auditor General further explained that, "we have earlier done the audit report conducted by HST; and according

to our rules, an audit firm has to consult the one that has done the work before taking the assignment”. Regarding this the researcher tried to get more information from auditor general, but the concerned official did not allow accessing to the right data saying that “the matter is confidential”.

Also the researcher tried to get data concerning the case form Ethiopian Professional Association of Accountants and Auditors (EPAAA), but because of confidentiality nature of the data the association did not allow the researcher access to the right data. However, as revealed from the interview response EPAAA is a voluntary association which has no power to take action on the auditors as well as accountants working in the country.

On the other hand, partner in HST justified the case on the same new letter that “the decision by the Auditor General is due to a” professional disagreement” and we have not violated any code of conduct” (see annex 7)

Similarly, as determined from the interview response of HST senior partner, “the firm had taken the job from the defendants (or defense Lawyers) and the auditors general was selected to conduct audit by the anti corruption commission. Thus they said, "Our clients are totally different. Besides we accepted the penalty only because of the fact that

auditor general was empowered by the law (declaration No. 68/1997) to issue, renew and withdraw licenses of accountants and auditors.”

Moreover, interview response of the HST senior partner revealed that, “An audit firm has to consult a clients previous auditor to learn whether the firm has had a professional related problem to leave the company before taking up the work, which is articulated in the Rule Book of ACCA,”. Also they said, “We did not violate a professional ethics, but this is a professional misinterpretation.”

From the above case analysis; it is possible to infer that;

- though the clients of the two auditors differ, and as far as the books of accounts audited is for the same organization the firm has violated professional ethics.
- the auditor general is a regulatory body of auditors and at the same time acting as an arbitrator. Hence, here there is a violation of professional ethics, because of the fact that one organ (body) should not be a regulatory body and at the same time auditor.
- there is a lack of well organized professional body which independently regulate the professionals. Thus, EPAAA (a voluntary association) has no power to regulate auditors and play a role for the development of the profession.

CHAPTER FIVE

MAJOR FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Major Findings

As it has been dealt with in this research, auditing standards provide minimum guidance for the auditor that helps to determine the extent of auditing steps and procedures that should be applied in the audit work. However, there have been circumstances when auditors are violating these minimum guidelines or auditing standards. Therefore on the basis of the analysis of the data the following major findings were obtained:

- The study revealed that most clients or audit organizations lack awareness about the purpose of getting their books of accounts audited. Because 45.46% and 36.36% of client respondents considered the purpose of audit report with creditors and taxation respectively.
- It was found out that, lack of a well organized professional body resulted in violation of professional ethics. Accordingly, although advertisement was the mostly used method for auditors selection as confirmed by 45.46% of the respondents, family or friend relationship was also used as confessed by 36.36% of the respondents

- As mentioned in the literature part of the paper auditors should be independent of their client both mentally and physically. Private auditors' independence from clients in their audit work was confirmed by 63.64% of client respondents and 85.71% of the interviewee. However, there was an occasion where private auditors by force or interest may violate the principle of auditor's independence from their clients in conducting an audit work (as replied by 36.36% of the clients and 14.29% of the interviewee).
- 72.73% of client respondents confirmed that, private auditors performing audit work were professionally trained and competent. However, 27.27% replied that there was a moment when incompetent auditors were coming to their organization to perform the audit work.
- According to 81.82% of client respondents, private auditors adequately plan their audit work and frequently supervise the work of field auditors.
- All the respondents (both clients and auditors) confessed that, private auditors properly exercise due professional care in the auditing process. The study result revealed that, the generally accepted accounting principles had been applied by the clients in the preparation of the financial statements.
- 63.64% of client respondents and 85.71% of the sampled auditors agreed that private auditors examine the internal control structure of

an audit entity for the purpose of gathering necessary information for the expression of an opinion.

- Though the majority of the respondents confirmed that auditors express an opinion based on international standards on auditing, there were situations where auditors give an opinion based on the demand of their clients as replied by 36.36% of the respondents.
- It was confirmed by the majority (72.73%) of client respondents that, audit organizations sign contractual agreement with auditors before auditing. However, 27.27% of the respondents disagreed with the existence of such practice.
- The study result showed that private auditors were made liable for violation of contractual Agreement signed between the audit organization and the auditor. Moreover, the study revealed that private auditors were also legally liable for violation of statutory responsibility.
- All the respondents confessed that, the preparation of financial statements was the responsibility of the management of the audit organization. Furthermore, the respondents confirmed that private auditors were legally liable for subsequently discovery of misstated audited financial statements. Moreover, 18.18% of the respondents revealed that there were circumstances when the same auditor was doing both the accounting and auditing services for one and the same client.

- It was found out in this study that, the following were identified as the major constraints to private auditors in attempting to exercise their responsibility. There were an occasions that clients demand unqualified opinion; there was low demand for audit service, and there was no strong professional association for auditors.

5.2 Conclusions

As it has been examined in this research, the purpose of auditing standards is to establish standards and provide guidance on the objective and principles governing an audit of financial statements. The objective of audit of financial statements is to enable auditors to give an opinion on those financial statements taken as a whole and thereby to provide reasonable assurance that the financial statements give a true and fair view and have been prepared in accordance with relevant accounting standards or other requirements.

Thus, formulation of these auditing standards is the responsibility of professional association or body, nationally or internationally. However, due to absence of well established professional accounting association in Ethiopia at the present time, there are no formalized professional standards issued by any authority in the country. However, OFAG have adapted minimum auditing standards incorporated in international audit standards.

As determined from the interview responses and observed by the student researcher in his five years auditing experience, absence of well organized professional body in Ethiopia may cause auditors not to

properly exercise their professional and legal responsibilities. For instance;

- lack of awareness of about the purpose of getting their books of accounts audited;
- there may be an occasion that organizations select auditors based on family or friends relationship,
- there is relatively auditor's dependence on their client's for financial and other interest,
- situations when auditor's give an opinion based on the demand of their clients, and clients demand unqualified opinion,
- doing both accounting and auditing services for one and the same client, which may result in violation of professional ethics.

On the other hand the research showed that preparation of financial statements is the responsibility of the management but the responsibility of auditors rest on examining the financial statements produced by the management and expressing an opinion based on findings. Besides, it has been identified through this study and in principle auditors are legally liable for subsequently discovered misstatement audited financial statements.

The research also identified auditors shall be civilly liable to the company and third parties for any fault in the exercise of their responsibilities

which occasioned loss. As per the law of the country, an auditor who knowingly gives or confirms an untrue report concerning the position of a company or fails to inform the public prosecutor of an offence which he known to have been committed shall be punished under Art. 438 or Art. 664 of penal code as the case may be. But as it has been revealed through this study there has been an occasion that auditors have been violating legal responsibilities. For instance there is a circumstance that auditors are not signing contract of agreement with their clients for the purpose of audit work, compromising of auditor independence, and assigning less competent auditors.

Therefore, from the overall results of the study which is based on the opinion of the respondents and some documents, although some of the professional and legal responsibilities of auditors have been adequately exercised by the private auditors, some problems have been detected by the study. Moreover, audit related cases have been noted and revealed showing some practical violation of auditors' professional and legal responsibilities (see case analysis earlier).

Hence, the case analysis revealed that auditor violated professional responsibility, as a result of which the regulatory body imposed a penalty on them and some cases are under process of investigation.

5.3 Recommendations

The following possible recommendations may be used in order to help auditors in exercising their professional and legal responsibilities, and in providing decision makers with relevant audit report.

- Auditors and accountants in Ethiopia as a whole should maintain a strong professional association or body.
- As much as possible the clients or audit organizations should employ professional accountant or train the existing staff in order to produce financial statements for themselves and become aware about the importance of getting their books of accounts audited regularly.
- There should be fair assignment of auditors by the professional association or the controlling authority based on quality of auditors. Thus, EPAAA and OFAG should work together in order to eliminate or minimize problems in this regard.
- Auditors should adapt signing a contract of agreement with the audit organizations before start auditing the books of accounts.
- Auditors shall assign field auditors who are competent but if competent staffs not exist they should train the existing staff in order to attain professional competence and also the staff

should be aware of the development of their profession and senior auditor's should supervise field auditors.

- Auditors should give an opinion based on the findings during an examination of financial statements not base on the wish of their client's.
- One and the same auditor should not audit the books of accounts of the same client for longer time period, may be for not more than three years.
- One and the same auditor should not provide both accounting and auditing services for one and the same client.

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Annex - 1

Table 1 Personal information of manager respondents

No	Items	Responses	
		No	%
1	Sex: a) Male	9	73.33
	b) Female	<u>2</u>	<u>26.67</u>
	Total	11	100
2	Nationality:		
	c) Ethiopian	11	100%
	d) Non-Ethiopian	<u>0</u>	<u>0</u>
	Total	11	100%
3	Educational qualification		
	f) Ph.D	2	18.18
	g) MA/MSc	4	36.37
	h) BA/BSc	3	27.27
	i) College Diploma	-	-
	j) Certificate	<u>2</u>	<u>18.18</u>
	Total	11	100

Annex - 2

Table 2 Characteristics of the sampled organizations/firms:

No	Items	Responses	
		No	%
1	Business Type:		
	d) PLC	6	54.55
	e) Share Company	3	27.27
	f) NGO	<u>2</u>	<u>18.18</u>
	Total	11	100
2	Category of business		
	e) Constriction	1	9.09
	f) Manufacturing	3	27.27
	g) Merchandising	5	45.46
	h) NGO	<u>2</u>	<u>18.18</u>
Total	11	100	
3	Year of establishment of the firm on average:		
	e) Less than 2 years	1	9.09
	f) 3 to 5 years	2	18.19
	g) 5 to 10 years	4	36.36
	h) Older than 10 years	<u>4</u>	<u>36.36</u>
Total	11	100	
4	Annual profit on average:		
	e) 10,000 - 50,000	2	18.18
	f) 50,000 - 100,000	5	45.46
	g) 100,000 - 500,000	3	27.27
	h) Above 500,000	<u>1</u>	<u>9.09</u>
Total	11	100	
5	Have branch in other country:		
	c) Yes	0	0
	d) No	<u>11</u>	<u>100</u>
	Total	11	100