



ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS

DETERMINANTS OF AUDIT FEE PRICING:
A CASE STUDY OF ETHIOPIAN AUDIT FIRMS

A THESIS SUBMITTED TO THE DEPARTMENT OF CORPORATE FINANCE IN PARTIAL
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Statement of Declaration

I hereby declare that this work entitled “*Determinants of Audit Fee Pricing: A Case Study of Ethiopian Audit Firms*” is my work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person nor material that has been accepted for the award of any other Master’s Degree, Bachelor Degree or Diploma of the university or other institute of higher learning except where due acknowledgement has been made in the text.

At this moment, I declare that the thesis titled “*Determinants of Audit Fee Pricing: A Case Study of Ethiopian Audit Firms*” is my original work and is being submitted as a partial fulfillment of the requirement for the Master of Science in Corporate Finance with a Specialty in Investment Management. I received close guidance and support from my advisor, Dr. Tesfa Nega, throughout the research process. I confirm this thesis has not been presented for the award at any other university. Furthermore, I have duly acknowledged all the sources of materials used in this thesis.

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Abstract

This study investigates the key determinants influencing audit fee structures among audit firms operating in Ethiopia. In the context of growing expectations for accountability and transparency within financial reporting, the research seeks to provide empirical evidence on how various client-specific and auditor-related factors impact audit pricing decisions. A structured questionnaire was distributed to a sample of 145 audit professionals, and a quantitative research approach was adopted for data analysis. The methodology involved the application of descriptive statistics, correlation analysis, and multiple linear regression to assess the relationship between audit fees and five main variables: client size, client risk, client complexity, auditor reputation, and market competition. The analysis yielded significant findings, indicating that client risk, complexity, auditor reputation, and competitive market forces have a statistically significant and positive effect on audit fees. These results suggest that audit firms in Ethiopia systematically adjust their pricing based on higher levels of perceived risk, operational complexity, reputational strength, and market competitiveness. Although client size demonstrated a positive correlation with audit fees, its influence was not statistically significant within the model. The robustness of the regression results was confirmed through diagnostic tests, all of which indicated compliance with the classical assumptions of linear regression ensuring the reliability and validity of the statistical inferences. These findings align with existing international research on audit fee determinants, thereby reinforcing their relevance in the Ethiopian context. The study provides practical implications for various stakeholders, including audit firms, regulators, and policymakers. Specifically, it emphasizes the need for audit firms to adopt more structured, transparent, and risk-based fee-setting practices. Additionally, it highlights the importance of regulatory guidance that considers market conditions and audit complexity to promote fair pricing and audit quality. Future research is encouraged to broaden the scope by incorporating additional influencing variables and employing longitudinal or panel data methods to capture trends and changes in audit pricing over time.

Keywords

Audit Fee, Client Risk, Client Complexity, Auditor Reputation, Market Competition,

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Abbreviation

AABE	Accounting and Audit Board of Ethiopia
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
ACCA	Association of Chartered Certified Accountants
GAAP	Generally Accepted Accounting Principles
AICPA	American Institute of Certified Public Accountants
PCAOB	Public Company Accounting Oversight Board
IDX	Indonesia Stock Exchange
PSE	Philippines Stock Exchange
SMP	Small Medium Practice

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Audit fee pricing has been extensively studied due to its significance for auditors, clients, and regulators. It is influenced by client-specific factors (size, risk, complexity), auditor-specific factors (reputation, firm size), and market-level dynamics (competition). Audit fees, agreed upon by clients and auditors, are crucial for ensuring audit quality and motivating auditors to thoroughly fulfill their duties. Adequate fees support high-quality audits, foster capital market efficiency, and uphold public trust, while insufficient fees can undermine auditor independence and diminish the quality of financial oversight.

In Ethiopia, the audit industry is vital for ensuring corporate governance and financial transparency, functioning under the oversight of the Accounting and Auditing Board of Ethiopia (AABE). Established through Proclamation No. 847/2014 and Regulation No. 332/2014, the AABE is responsible for regulating and advancing the accounting and auditing profession in the country. While the sector has experienced growth, it continues to face challenges, including limited professional capacity, changing regulations, and intense competition. Audit fees in Ethiopia are affected by factors such as client complexity, client size, client risk, firm reputation, firm resources, and market competition. These fees directly influence the resources allocated to audits, impacting their depth and reliability. Ensuring fair audit fees is essential for maintaining stakeholder confidence, adhering to international financial reporting standards (IFRS), and promoting economic stability.

Audit fee pricing involves multiple factors influenced by both client and auditor-related elements. Simunic (1980) explores the relationship between audit fees and the scale and complexity of businesses, using total assets as a metric for both. His empirical research shows a significant positive correlation between the total assets of an audited unit and the audit fees charged. Larger businesses, with more substantial total assets, typically incur higher audit fees, mainly due to the increased complexity and breadth of their financial reporting and auditing demands. The study emphasizes that the total assets of an entity are critical determinants in establishing audit fees, as they reflect both the operational scale and the complexity of the audit process. This relationship indicates that larger, more intricate firms necessitate more extensive audit services, justifying the higher fees they incur.

Empirical research in China consistently demonstrates a positive correlation between the size of the assets of audited units and audit fees, with larger firms paying higher fees. Wu (2003) utilized the natural logarithm of total assets as a measure of company size and found that a company's size has a significantly positive effect on the annual audit fees. Similarly, Wang and Liu (2007) employed total assets to represent the scale of the audit firm and verified these findings through correlation tests. Both studies reveal that larger firms, with more considerable assets, require more comprehensive audits, leading to higher fees. This connection underscores the increased complexity of auditing larger entities and the resources necessary to conduct such audits.

Client complexity, which includes factors such as diversified operations, international transactions, and sophisticated financial reporting, also significantly affects audit fees. Wang, Zhang, and Yang (2010) examine the long-term factors that influence audit fees in their study. They identify key determinants, including the size of the client company, financial complexity, and the characteristics of the audit firm, such as its size and reputation. The study highlights that larger, more complex firms incur higher audit fees due to the greater resources and expertise required.

Amba and Al-Hajeri (2013) found that several factors significantly influence audit fees in Bahrain, including the volume of transactions, the number of subsidiaries, the ratio of accounts receivable and inventory, information technology, and regulations. These factors were all statistically significant predictors of audit fees. However, the researchers emphasized that audit fees cannot be fully understood without considering other economic factors that may play a role in determining pricing.

In Ethiopia, a study by Dawit Abera Keno (2019) evaluating the determinants of external auditor fees in the banking and insurance industries found that the size, experience, and complexity of both the client and auditor are critical in determining audit fees.

In Ethiopia, audit complexity, including the adoption of International Financial Reporting Standards (IFRS), significantly impacts audit fees. Complexities such as the size and structure of firms, the number of subsidiaries, diversified operations, and intricate financial reporting requirements increase the effort and expertise needed for audits. The implementation of IFRS has added to this complexity, requiring auditors to adapt to new standards and provide additional support to clients in transitioning and maintaining compliance. These factors lead to higher audit fees, as auditors invest more resources and time to address the challenges posed by complex operations and IFRS adoption.

Audit risk plays a significant role in determining audit fees. Higher audit risks, such as inherent risk and control risk, typically lead to higher fees, as auditors must allocate more resources and effort to mitigate these risks. Inherent risk reflects the susceptibility of financial statements to material misstatements, while control risk concerns the effectiveness of internal controls in preventing such errors. These risks increase the complexity of the audit, necessitating more thorough work and, consequently, higher fees. On the other hand, detection risk, which involves the auditor's ability to detect material misstatements, is generally considered less impactful in determining audit fees.

Muhajir (2018) examines the impact of audit risk on audit fees and finds that inherent risk and control risk significantly influence the determination of audit fees. These two risks are crucial factors in setting audit prices, as they reflect the complexity and the potential for misstatement in financial statements. However, the study concludes that detection risk, which arises from the auditor's failure to detect material misstatements, does not have a significant impact on audit fee determination.

Auditor reputation significantly influences audit fees, with highly reputable firms typically charging higher fees due to the perceived value and quality of their services. A strong reputation is built on consistent audit quality, ethical conduct, and expertise, which enhance client trust and market perception. Reputable auditors are often viewed as more reliable, providing thorough, credible audits that reduce the risk of financial misstatements or fraud, leading clients to pay a premium for their services. Firms with a solid reputation can differentiate themselves in a competitive market, attracting higher-profile clients who value their assurance of high-quality audits. Moreover, the complexity and regulatory requirements associated with reputable audit firms often result in more extensive audit processes, further justifying higher fees. In addition, clients seeking to manage risk and ensure compliance are more willing to pay for a trusted auditor. Francis (2004) highlights that reputable audit firms, especially those affiliated with international networks, are often perceived as offering higher-quality services, which leads them to charge premium audit fees. The study also looks at the role of regulations, audit procedures, and the impact of market conditions on the quality of audits.

Aronmwan, Ogbuabor, and Oghoghomeh (2013) explore the relationship between audit firm reputation and corporate image, focusing on Nigerian audit firms. The study highlights that a firm's reputation is closely linked to its corporate image, which develops over time through consistent performance, ethical conduct, and the quality of services provided. The authors argue that audit firms with strong reputations

are more likely to attract clients, maintain trust, and ensure long-term success. The research emphasizes the importance of building and maintaining a positive corporate image, as it influences client perception and the overall credibility of the audit firm in the market.

The reputation of Ethiopian auditors, like auditors in many emerging markets, varies based on several factors, such as the quality of their work, their ethical standards, and their relationships with clients. Generally, auditors in Ethiopia may not have the same level of global recognition or reputation as firms from international networks like the "Big Four" (e.g., Deloitte, PwC, EY, and KPMG), which dominate in many developed markets. However, there are reputable local audit firms in Ethiopia that have built trust over time with their clients, particularly in sectors like banking, government, and large private corporations. The reputation of these firms often depends on the quality of service, regulatory compliance, experience and track record, and affiliation with international networks.

Competition in the audit market significantly influences audit fees, with both positive and negative effects. Increased competition can drive down fees as firms lower prices to attract clients or win contracts. However, competition can also lead to improved differentiation, where firms offer specialized services or advanced technologies, potentially charging higher fees for added value. On the downside, intense competition may compromise audit quality, as firms may cut costs and reduce the scope of audits to meet low fee targets, increasing the risk of undetected misstatements. In some cases, competition can lead to higher fees for high-quality audits, particularly when firms prioritize maintaining audit reliability and meeting client and regulatory expectations.

Gerakos and Syverson (2015) examine the impact of competition in the audit market, focusing on how it affects audit fees and audit quality. The study finds that while increased competition can drive down audit fees and lead to greater differentiation among audit firms, it can also have negative effects on audit quality. Specifically, the pressure to offer lower fees may incentivize some firms to reduce the scope or thoroughness of audits, potentially compromising the reliability of financial statements.

Chui (2015) investigates the relationship between product market competition and audit fees. The study examines how competitive pressures in the market affect the pricing of audit services. The authors find that in highly competitive product markets, companies may face lower audit fees due to the pressure to reduce costs. However, they also note that increased competition can lead to higher audit fees in certain

contexts, particularly when firms seek high-quality audits to reduce the risk of financial misstatements and enhance credibility.

Ethiopia's audit industry is dominated by small and medium-sized firms, limited professional capacity, and less stringent regulatory frameworks compared to developed economies.

This study aims to explore the determinants of audit fee pricing, offering valuable insights for various stakeholders. For audit firms, understanding these factors helps establish fair and competitive pricing strategies. Clients benefit by gaining a clearer understanding of what drives audit costs, allowing for more informed financial planning and decisions. Regulators and policymakers can leverage this knowledge to enhance transparency and ensure fairness in the audit market.

The research is especially significant in the Ethiopian context, where there is a lack of empirical studies on audit fee determinants from the firm's perspective. By analyzing these factors, the study contributes to the broader literature on audit pricing, offering lessons for other developing economies. Additionally, it provides practical recommendations for Ethiopian audit firms to enhance their competitiveness and align with global best practices. Ultimately, the study aims to offer a comprehensive analysis of the elements affecting audit fee pricing in Ethiopian audit firms, addressing both theoretical and practical aspects to strengthen the country's audit industry.

1.2 Statement of the Problem

In Ethiopia, audit fee determination remains inconsistent and often arbitrary, primarily due to the absence of a well-established empirical framework and the presence of a weak regulatory environment. Unlike in developed economies, where the factors influencing audit fees are extensively studied and better understood, Ethiopia's auditing sector faces distinct economic, regulatory, and market challenges that make audit pricing highly unpredictable.

The lack of standardized pricing guidelines has led to significant discrepancies in audit fees for similar services, fostering an unfair competitive environment among audit firms. In many cases, firms may underprice their services to attract clients, which can undermine audit quality and compromise the reliability of financial reporting. Additionally, clients often lack sufficient information to understand or negotiate audit fees effectively, diminishing transparency and market efficiency. Smaller audit firms, in

particular, are disadvantaged, as they struggle to compete with larger firms, resulting in market distortions that threaten the sustainability and integrity of the auditing profession in Ethiopia.

Audit fee setting is a critical issue because it directly affects audit quality, stakeholder confidence, and the credibility of financial reporting. However, Ethiopia's auditing sector is challenged by limited resources, a dynamic and underdeveloped economic environment, and weak monitoring by the Accounting and Auditing Board of Ethiopia (AABE), particularly in enforcing compliance with International Standards on Auditing (ISAs). These systemic challenges create inconsistencies in audit fee practices and emphasize the need for a deeper understanding of the factors influencing pricing decisions.

Globally, research shows that audit fees are influenced by factors such as client size, complexity, risk, auditor reputation, and market competition (Simunic, 1980; Hay et al., 2006). While these factors are well-established in developed markets, their applicability to Ethiopian audit firms is still unclear. Ethiopia's unique economic environment, characterized by a mix of formal and informal business practices, limited enforcement of auditing standards, and emerging capital markets, introduces complexities that may cause audit fee structures to differ from those in global markets.

Although previous studies in Ethiopia, such as those by Tamrat (2014) and Getachew (2016), have examined audit fee determinants and audit quality within the banking sector, particularly in commercial and private banks. These studies focused on factors like bank size, audit firm size, profitability, liquidity risk, credit risk, operating risk, capital risk, and audit quality. However, they did not investigate audit fee pricing from the perspective of audit firms themselves.

In the absence of empirical evidence, audit firms may find it difficult to set competitive and fair fees while maintaining quality standards, and clients may face challenges in negotiating reasonable fees. Therefore, this study seeks to investigate the key determinants influencing audit fee pricing within Ethiopian audit firms, aiming to fill the existing research gap and contribute to improved audit practices in an emerging market environment.

1.3 Research questions

Corresponding to the research objectives, the study answered the following research questions:

1. How does the size of a client (e.g., total assets, revenue, or employee numbers) affect the pricing of audit fees in Ethiopian audit firms?
2. How does client risk influence the determination of audit fees among Ethiopia audit firms?
3. To what extent does the complexity of a client's operations (e.g., multi-branch presence, international operations, diversified business lines) influence the audit fees charged by Ethiopian audit firms?
4. To what extent does auditor reputation influence clients' willingness to pay higher audit fees in Ethiopian audit firms?
5. How does market competition among audit firms in Ethiopia influence the pricing of audit services?

1.4 Research objectives

1.4.1 General Objective:

The general objective of this study is to investigate the determinants influencing audit fee pricing in Ethiopian audit firms, focusing on the impact of client size, client risk, client complexity, auditor reputation, and market competition.

1.4.2 Specific Objectives:

Concerning the above general objective, the following points are set as the specific objectives of the study:

1. To assess the impact of client size on audit fee pricing in Ethiopian audit firms.
2. To analyze the effect of client risk on audit fee pricing in Ethiopian audit firms.
3. To examine how the complexity of a client's operations influences the determination of audit fees in Ethiopian audit firms.
4. To evaluate the extent to which auditor reputation affects clients' willingness to pay higher audit fees in Ethiopian audit firms.
5. To investigate the impact of market competition among audit firms on audit fee pricing in Ethiopia.

1.5 Research Hypothesis

The study examines the following hypothesis:

H1.1: Client size has a positive and significant effect on audit fees.

H1.2: Client risk has a positive and significant effect on audit fees.

H1.3: Client complexity has a positive and significant effect on audit fees.

H1.4: Auditor reputation has a positive and significant effect on audit fees.

H1.5: Market competition has a negative and significant effect on audit fees.

1.6 Significance of the Study

The study on the determinants of audit fee pricing in the case study of Ethiopian audit firms is highly significant for several reasons, as it examines how various factors such as client size, client risk, client complexity, auditor reputation, and market competition influence audit fee structures in Ethiopia.

The findings of this study have practical implications for Ethiopian audit firms, clients, regulatory bodies, and academic literature. Audit firms can better understand pricing factors, adjust strategies for fee structuring, and improve transparency and audit quality. Clients will gain insights into audit fee determinants, enabling more informed decision-making and cost-benefit analysis of audit services. Policymakers and regulators can use the findings to formulate policies that promote fair pricing and ethical practices, ensuring market oversight and detecting anti-competitive behavior. Academically, the study will fill gaps in the limited research on audit fee pricing in Ethiopia, offering a framework for future studies and enhancing understanding of audit pricing dynamics in developing economies.

1.7 Scope of the Study

The scope of this study is defined by its objective: to identify and analyze the determinants influencing audit fee pricing among audit firms in Ethiopia. Thematically, the research centers on key factors that may affect audit fees, specifically client size, client risk, client complexity, auditor reputation, and market competition. Geographically, the study is confined to audit firms operating within Ethiopia, excluding firms outside the country. In terms of organizational coverage, the study includes both small and medium-sized practices (SMPs) and larger audit firms, ensuring a comprehensive representation of different firm sizes and operational contexts within the Ethiopian audit sector.

Temporally, the study focuses on the current state of audit fee pricing practices, reflecting the most recent trends and conditions in the profession. Methodologically, the study adopts a quantitative case study

design. Data were collected exclusively through structured Likert-scale questionnaires distributed to audit professionals, providing standardized responses that support statistical analysis. This approach allows for the identification of patterns and relationships among the selected variables, offering a clear and data-driven understanding of the determinants of audit fee pricing in Ethiopia.

1.8 Limitations of the Study

This study is geographically limited to audit firms operating in Ethiopia, primarily those registered and recognized by the Accounting and Auditing Board of Ethiopia (AABE). As a result, the findings may not be easily generalized to audit markets in other countries that operate under different regulatory, economic, and cultural conditions. The research focuses specifically on key determinants of audit fee pricing such as client size, client risk, client complexity, auditor's reputation, and market competition within the Ethiopian context. Additionally, the study targets audit professionals who are directly involved in audit planning and fee determination processes. While this approach ensures that the data is gathered from those with practical and decision-making responsibilities, it may exclude perspectives from other relevant stakeholders such as clients, regulators, or junior audit staff who may also influence audit fee outcomes indirectly.

1.9 Organization of the Study

This research paper is divided into five chapters that systematically explore the factors influencing audit fee pricing in Ethiopian audit firms. The introduction provides the study's background, highlights the research problem, outlines the objectives, and defines the study's scope. The literature review critically analyzes previous local and international studies, forming the theoretical and empirical base for the research. The methodology section explains the quantitative approach, data sources, sampling methods, and the use of structured Likert-scale questionnaires for data collection. The results and discussion chapter presents statistical findings and examines how key factors like client size, risk, complexity, auditor reputation, and market competition influence audit fees. Finally, the conclusion summarizes the main findings and offers recommendations for audit professionals, regulators, and future researchers.

CHAPTER TWO

RELATED LITERATURE REVIEW

2. Introduction

The main goal of this chapter is to empower readers to get an understanding of what is already known within the area of study. Principally, it focuses on the review of both the theoretical and empirical evidence on the determinants of audit fee pricing in the case study of Ethiopian audit firms.

The introduction to the literature review further underlines the need to bridge this gap by examining the interplay of client attributes, auditor characteristics, and contextual factors within the Ethiopian audit market. This sets the stage for a comprehensive exploration of audit fee pricing determinants in Ethiopia, contributing both to academic literature and practical insights for policymakers and practitioners.

2.1 Theoretical Review

An audit fee refers to the payment made to an auditor for conducting the annual financial statement audit of a client firm. Audit pricing is a multifaceted process that considers various attributes of both the client and the auditor. Central to determining audit fees is the quality of audit services, as stakeholders depend on audited financial statements for critical decision-making. Neglecting the implications of audit quality can result in significant legal risks, especially in cases of audit failures.

DeAngelo (1981) conceptualized audit quality as the market-perceived joint probability that an auditor will identify errors in a client's accounts and report them to relevant parties. The likelihood of detecting errors depends on the auditor's expertise, experience, and technological capabilities, while the likelihood of reporting these errors is tied to the auditor's independence.

Existing literature highlights several auditor-client dynamics that influence both audit quality and independence. Following notable accounting scandals in the West, the auditing profession has come under greater scrutiny from researchers. Factors such as non-audit services, excessively high audit fees, extended audit tenure, and the size of the auditing firm have been found to affect audit quality and auditor independence.

2.1.1 Definition and Objective of an Audit

An audit is defined as "an independent examination of financial statements and records of an organization, aimed at providing an objective opinion on whether they present a true and fair view of the entity's financial position. The primary purpose of an audit is to enhance the credibility of financial reporting, ensuring compliance with applicable laws, accounting standards, and regulations" (Hayes et al., 2021). Similarly, Arens et al. (2022) describe an audit as "an independent examination of financial statements to provide an objective evaluation of whether they are prepared by generally accepted accounting principles (GAAP) or other relevant standards. The primary objective of an audit is to offer reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error."

The primary objective of International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit by International Standards on Auditing*, is to establish the independent auditor's responsibilities when conducting an audit of financial statements. ISA 200 highlights the importance of professional skepticism, ethical compliance, and professional judgment throughout the audit process to ensure the quality and reliability of the auditor's opinion (IFAC, Revised 2020).

2.1.2 Importance of Audit Fees Pricing

Audit fees represent the monetary compensation paid to external auditors for conducting independent examinations of financial statements. These fees serve as an economic link between auditors and their clients, reflecting the effort, expertise, and resources required to deliver quality audits (Simunic, 1980). The significance of audit fees has been widely discussed in academic literature, particularly concerning their role in audit quality, financial transparency, and accountability.

2.1.2.1 Audit Fees as Indicators of Audit Quality

Audit fees are often viewed as a proxy for audit quality because they reflect the time, effort, and resources auditors allocate to an engagement (Francis, 2004). Higher audit fees are associated with more rigorous audit processes, which enhance the reliability of financial reporting. This relationship highlights the importance of audit fee pricing in fostering stakeholder confidence and supporting informed decision-making.

2.1.2.2 Insights into Client Complexity and Risk

The pricing of audit fees also offers insights into the complexity and risk of a client's operations. Research suggests that higher audit fees are often linked to firms with greater operational risks, extensive regulatory requirements, or industry-specific challenges (Hay et al., 2006). These factors influence the scope of audit work and, consequently, the fees charged.

2.1.2.3 Regulatory and Market Influences

The dynamics of audit fee pricing are influenced by regulatory frameworks and market conditions. Carson et al. (2012) argue that increased regulatory scrutiny, such as the introduction of Sarbanes-Oxley in the United States, has led to higher audit fees due to the expanded scope of auditor responsibilities. Similarly, market competition among audit firms can affect pricing, potentially influencing audit quality and independence (Simunic, 1984).

2.1.2.4 Role in Auditor Independence and Accountability

Properly priced audit fees help ensure auditor independence by minimizing the risk of low-balling, a practice where auditors accept fees below cost to secure future engagements (DeAngelo, 1981). Adequate pricing supports accountability and the delivery of unbiased opinions, thus safeguarding the integrity of financial reporting.

2.1.3 Role of the Audit Process

Auditing plays a pivotal role in ensuring the credibility and reliability of financial reporting. External auditors are integral to this process, acting as independent intermediaries between management and stakeholders. This literature review explores the various roles of external auditors in the audit process, including providing assurance, enhancing corporate governance, fostering transparency, and mitigating risks.

2.1.3.1 Assurance and Credibility

External auditors play a crucial role in providing an independent opinion on the fairness and accuracy of an entity's financial statements (Hayes et al., 2021). By adhering to established auditing standards such as the International Standards on Auditing (ISA), auditors ensure that financial statements are free from material misstatements, whether caused by fraud or error (IFAC, 2020). This independent verification of financial information is vital for maintaining the integrity of the financial reporting process.

The assurance provided by auditors enhances the credibility of financial statements, giving stakeholders such as investors, creditors, and regulators the confidence to make informed decisions. For investors, auditors' independent opinions offer reassurance that the financial data accurately reflects the company's financial health, reducing the risk of financial misrepresentation. Similarly, creditors rely on the auditor's assurance to assess the viability and creditworthiness of potential borrowers. Regulatory bodies also use auditors' reports to ensure that companies comply with financial reporting standards, thus safeguarding the broader financial system's integrity.

2.1.3.2 Strengthening Corporate Governance

External auditors play a critical role in enhancing corporate governance frameworks. By ensuring that management presents financial statements fairly and complies with applicable laws and regulations, auditors contribute to greater accountability and ethical practices within organizations (Cohen et al., 2004). Their involvement provides boards of directors and audit committees with independent insights into the financial health and risks of the organization, supporting effective oversight.

2.1.3.3 Mitigating Risk and Detecting Fraud

Auditors play a crucial role in identifying and mitigating potential risks within an organization, particularly those that could lead to financial misstatements. By evaluating the effectiveness of internal control systems, auditors assess areas where weaknesses may exist, increasing the likelihood of fraud or errors. This proactive approach enables auditors to identify and address risks before they materialize into significant financial discrepancies.

Risk-based auditing, as outlined by Knechel (2007), allows auditors to prioritize high-risk areas during the audit process. By focusing resources on these areas, auditors can more effectively allocate time and effort where it is most needed, increasing the likelihood of detecting fraud or financial misreporting. This approach ensures that audit procedures are both efficient and comprehensive, safeguarding the integrity of financial statements.

2.1.3.4 Promoting Transparency and Accountability

Auditors play a vital role in promoting transparency by ensuring that financial statements accurately reflect an organization's financial performance and position. Through rigorous examination and adherence to auditing standards, auditors provide a true and fair view of a company's financial health, fostering openness and clarity in its financial reporting. This transparency is crucial for building and maintaining trust with stakeholders, including investors, creditors, and regulators, who rely on accurate financial data for decision-making.

Furthermore, auditors contribute to organizational accountability by issuing audit reports that assess the fairness and accuracy of financial statements. These reports hold management accountable for their financial reporting obligations and ensure that they comply with relevant regulations and standards. According to DeAngelo (1981), the auditor's independent opinion serves as a safeguard, ensuring that management fulfills its responsibility to provide truthful financial information. Through their oversight, auditors help organizations meet public and regulatory expectations, reinforcing the credibility of financial reporting and supporting the long-term stability of the financial system.

2.2 Related to Audit Fee Pricing Theories

Audit theories would provide a theoretical foundation for understanding the factors influencing how audit firms set their fees. Some of the relevant and recent audit theories include:

2.2.1 The Agency Theory

Watts and Zimmerman (1978) view a company as a network of contracts involving various interest groups (e.g., shareholders, employees, suppliers). These groups seek to protect and pursue their interests while contributing to the firm. Management's role is to coordinate these interests, balancing costs such as paying dividends, securing low-interest rates, and setting competitive wages. The theory focuses on the principal-agent relationship, where one party (the principal) delegates tasks to another (the agent) and addresses potential conflicts of interest and risk-sharing issues due to divergent risk attitudes between the parties (Eisenhardt, 1989).

The agency theory provides a framework for understanding the relationship between principals (owners) and agents (managers) in organizations. It posits that conflicts arise due to the divergence of interests between these parties, primarily when the agent pursues their own goals rather than the principal's (Jensen & Meckling, 1976). To mitigate this conflict, principals often employ mechanisms such as monitoring, incentives, and contracting, which, in turn, incur agency costs.

Given its significance, agency theory is widely applied in understanding audit fee pricing. Larger or more complex firms tend to face higher agency costs, necessitating more rigorous audits and consequently higher audit fees (DeFond & Zhang, 2014). Thus, audit pricing reflects the perceived risk, the scope of the audit, and the mechanisms required to align agent-principal interests.

A key assumption of agency theory is the separation of ownership and control, leading to conflicts of interest, especially between shareholders (principals) and management (agents). Audits play a crucial role in resolving these conflicts by providing independent assurance to shareholders about the financial health and practices of the company, helping mitigate information asymmetry between the parties.

2.2.2 Signaling Theory

Signaling theory examines how one party conveys information to another to reduce information asymmetry in decision-making. Initially developed in the context of labor markets by Spence (1973), the theory has been widely applied in various fields, including finance, marketing, and corporate governance. According to the theory, signals are actions or attributes that communicate credibility, quality, or intentions to the receiving party, who uses these signals to infer unobservable characteristics.

In corporate settings, signaling theory explains how companies use mechanisms like financial disclosures, corporate social responsibility initiatives, or audit engagements to signal their quality and reliability to stakeholders (Ross, 1977). For instance, obtaining an audit from a reputable firm sends a strong signal to investors about the credibility of financial statements and the firm's commitment to transparency.

In the context of audit fees, signaling theory suggests that higher audit fees may reflect the perceived quality of the audit service, especially when larger or well-known audit firms are involved. These fees act as signals of rigorous scrutiny and higher assurance levels, which can enhance stakeholder confidence and reduce uncertainty in decision-making processes.

2.2.3 Behavioral Theories in Auditing

Behavioral theories in auditing explore how human behavior, decision-making, and psychological factors influence the audit process. These theories focus on understanding the cognitive biases, judgment heuristics, and social dynamics that affect auditors' performance and decision-making. Behavioral auditing research emerged as a response to the limitations of purely economic or rational models, which often overlook the complexities of human behavior (Libby, 1981).

Key behavioral factors include professional skepticism, which requires auditors to critically assess evidence and question management assertions, and judgment biases, such as overconfidence or anchoring, which can impact the evaluation of audit evidence (Trotman et al., 2015). Additionally, organizational and environmental factors, such as time pressure, workload, and client relationships, are significant influences on auditor behavior.

Behavioral theories also examine how group dynamics, such as team interactions and the influence of senior auditors, shape decision-making. For instance, audit quality may be compromised if subordinates conform to the opinions of more experienced team members without sufficient scrutiny. Understanding these behavioral aspects is critical for designing training programs, audit procedures, and regulatory frameworks to improve auditor judgment and reduce errors.

2.2.4 Resource-Based Theory (RBT)

The Resource-Based Theory (RBT) emphasizes that an organization's competitive advantage is derived from its internal resources, which must be valuable, rare, inimitable, and non-substitutable (Barney, 1991). In the context of audit fee pricing, RBT highlights how audit firms leverage their resources, such as specialized knowledge, technological capabilities, reputation, and industry expertise, to differentiate their services and justify premium pricing. Audit firms with highly skilled auditors, advanced auditing technologies, or a strong reputation can command higher fees due to the enhanced quality of services provided and the greater trust they inspire among clients.

Furthermore, firms that specialize in certain industries or have expertise in managing complex client risks may offer unique value to clients, enabling them to charge higher prices. RBT also explains why audit firms invest heavily in continuous training, technology upgrades, and quality control mechanisms to enhance their resources and remain competitive in the market (Peteraf, 1993). Such investments improve audit outcomes, strengthen client relationships, and provide a sustainable competitive edge. In essence,

RBPT helps explain how the strategic use and development of internal resources contribute to audit fee structures and pricing decisions.

2.2.5 Risk-Based Pricing Theory (RBPT)

Risk-Based Pricing Theory (RBPT) is grounded in the notion that service pricing should reflect the level of risk associated with a client or transaction (Campbell et al., 2008). In the audit context, RBPT suggests that audit fees are directly influenced by the client's risk profile. Higher-risk clients—characterized by financial instability, complex operations, regulatory issues, or weak internal controls—require more audit effort and detailed scrutiny to ensure compliance with auditing and financial reporting standards. As a result, auditors charge higher fees to compensate for the additional work and the potential risk of audit failure or litigation.

RBPT also incorporates various types of risk, including financial risk, operational risk, and reputational risk. For instance, clients with volatile earnings or those operating in highly regulated industries may face increased audit scrutiny, which can drive up audit fees (Bell et al., 2001). Similarly, the size and complexity of a client's operations can elevate risks and require more resources during the audit process. By incorporating client-specific risks into pricing decisions, RBPT allows audit firms to appropriately allocate audit resources and ensure a fair return for the level of effort and risk assumed. This theory is particularly useful in developing transparent, equitable pricing strategies that reflect the diverse risk profiles of clients.

2.3 Determinant of External Audit Fees Pricing

The pricing of external audit fees is influenced by various determinants categorized into client-specific, auditor-specific, engagement-related, and regulatory aspects. Each plays a significant role in shaping the costs associated with audit services.

2.3.1 Client-specific

Audit fees are significantly influenced by client-specific factors, including size, complexity, financial condition, and industry. Larger organizations typically incur higher audit fees due to the increased effort and resources required to audit their operations. This is particularly true for firms with complex structures,

as auditors need to devote more time and expertise to ensure that financial statements accurately reflect the business's activities (Hay et al., 2006).

Furthermore, the financial condition of a client can also impact audit fees. Clients with a more complex financial structure, higher levels of debt, or a history of financial instability present higher risks for auditors, leading to more thorough audits and, consequently, higher fees. Additionally, firms operating in high-risk or highly regulated industries, such as finance or healthcare, typically face increased scrutiny from regulators, which necessitates additional auditing procedures to ensure compliance with industry standards and regulations (Simunic, 1980). This additional scrutiny often results in higher audit costs, as auditors must allocate more resources to assess compliance with relevant laws and regulations.

2.3.2 Auditor Attributes

Auditor attributes, such as reputation, size, and expertise, significantly influence audit fee determination. One of the most notable factors is the reputation of the audit firm. Large, well-established firms, particularly the Big Four audit firms, command higher fees due to their perceived quality, brand value, and market dominance (Francis, 2004). These firms are often seen as providing more reliable and thorough audits, which justifies their premium pricing.

Additionally, the size of the audit firm impacts fees, as larger firms generally have more resources and specialized personnel to allocate to complex audit engagements. As a result, they can handle large, diverse clients with complex operations more effectively, often charging higher fees in recognition of the resources they deploy.

Moreover, specialized expertise in certain industries or in handling complex engagements further drives audit fees. Audit firms with specific knowledge of niche sectors, such as financial services or healthcare, can charge higher fees due to the specialized skills and in-depth industry understanding required to manage such audits (Knechel et al., 2007). This expertise allows firms to provide more comprehensive services, thus increasing the audit cost.

2.3.3 Engagement Specifics

The scope, complexity, and inherent risks of an audit engagement play a crucial role in determining audit fees. More complex audits, such as those involving multinational entities or intricate financial transactions, require additional resources and specialized expertise, which naturally results in higher fees.

The complexity of these engagements often demands extensive planning, coordination, and the involvement of experts with deep knowledge of specific areas, contributing to the overall cost (Simunic, 1980).

In addition to complexity, the level of audit risk also influences pricing. Audit risk refers to the possibility that the auditor may issue an incorrect opinion on the financial statements due to errors or fraud. Engagements that involve higher risks, such as those in industries prone to fraud or with complex financial instruments, require more rigorous auditing procedures and additional scrutiny. These high-risk engagements necessitate more time, effort, and expertise, which increases the cost of the audit (Knechel, 2007). Auditors must allocate more resources to ensure that the financial statements are free from material misstatements, further justifying the higher fees charged.

Thus, both the complexity of the audit and the associated risks significantly shape the pricing structure, ensuring that auditors are compensated fairly for the increased effort and resources required in such engagements.

2.4 Empirical Studies on Determinants of Audit Fee Pricing

Audit fees are a significant area of study in the auditing profession. They are influenced by several factors such as firm size, complexity of the audit, regulatory environment, and market conditions. Understanding the determinants of audit fee pricing in Ethiopia can provide insights into the local audit industry and its alignment with international practices. This review explores the key determinants of audit fees based on global and local literature, with a focus on evidence from Ethiopian audit firms.

2.4.1 Firm Size and Complexity

Audit fees are mostly determined by the size and complexity of the organization, according to empirical research. Larger companies tend to have more complex financial statements, which call for a more thorough and drawn-out audit procedure. As a result, more audit resources are required, which raises audit fees. These resources include a larger audit team, specialized skills, and more audit methods. Another important factor is the complexity of the audit. Complex audits deal with complicated financial transactions, several subsidiaries, overseas operations, or specific business procedures. Higher levels of

knowledge and time are frequently needed to handle these complications, which inevitably raise audit prices.

In the study, Syafii and Dewi (2019) analyze that firm size has a significant positive effect on audit fees on services sector companies listed in the Indonesia stock exchange (IDX) to an Indonesian company and services sector Philippines company listed in the Philippines stock exchange (PSE) in 2017 until 2019. The highest audit fee occurs due to the auditor taking longer to complete the task of the audit and ensure that the company has been inspected with an adequate sample. Companies that have total assets (wealth) are high making process audits conducted by auditors increasingly complicated. It would lead to rapidly increasing in audit fees charged to the company.

Additionally, firm complexity has a significant positive effect on audit fee services in sector companies listed in the Indonesia stock exchange (IDX) to an Indonesian company and services sector Philippines company listed in the Philippines stock exchange (PSE) from 2017 to 2019. Companies that have subsidiaries will have an impact on the audit process is further complicated because the company must create a consolidated report, so that the firm complexity will force auditors doing to do some service required a longer time, so then the fee to be received by the auditors is also getting big.

According to Van et al. (2022) study explores factors related to audit fees and quality, including contract types and audit complexity, audit firms' reputation, audit firms' size, and audit risk. The findings confirmed that audit firms, audit firm size, audit risks, contract type, and audit complexity have significantly affected audit fees and quality, while audit tenure does not significantly affect audit fees and quality.

Besides, the specialized field of audit firms has a positive impact on audit fees, and audit fees affect audit quality. This study provides several implications for managers in determining appropriate audit fees and audit quality strategies. To have a competitive pricing strategy and willingness to pay from customers, audit firms should build a good reputation, increase the firm size, perform the procedures in response to audit risk, separate audit contract types, and determine the complexity of audit projects and specialties.

In the study, Nyuykighan (2023) explores the factors influencing audit fees in Cameroon. The study identifies key determinants, including the characteristics of the audit firm, the auditee (client), and the auditor. The research highlights how factors such as the audit firm's experience, client complexity, the duration of the audit mandate, and the industry type contribute to the setting of audit fees. Additionally,

the study finds that many companies do not disclose audit and non-audit fees, suggesting a need for more transparency. The author recommends that regulations be introduced to mandate the disclosure of these fees, improving transparency and allowing stakeholders to better assess the reliability of financial reports.

Dilie, W. (2021) investigates the determinants of audit fees in private banks in Ethiopia, focusing on factors such as bank size, complexity, and risk. The study finds that larger banks and those with more complex operations incur higher audit fees due to the need for more resources and specialized expertise. Additionally, the research highlights the role of audit tenure in determining fees, with longer-term auditor-client relationships leading to higher audit costs. However, the study reveals that factors such as audit firm size and audit risk have a limited impact on audit fee structures in the context of Ethiopian private banks.

Tamirat (2014) investigates the determinants of audit fees among eight Ethiopian banks from 2004 to 2012, analyzing eight independent variables, including bank size, auditor size, profitability, liquidity, credit risk, management efficiency, capital adequacy, and earnings management. The study identifies client size, complexity, and industry characteristics as key factors influencing audit fees. Larger and more complex firms incur higher fees due to the additional resources required for comprehensive audits. Audit risk is also a significant determinant, with high-risk sectors like banking and manufacturing facing elevated costs due to increased scrutiny. Additionally, the reputation and size of the audit firm impact pricing, with larger firms charging higher fees due to their perceived superior quality and expertise.

Getachew (2016) investigates the factors affecting audit fees in the Ethiopian private commercial banking industry, focusing on variables such as board characteristics, audit committee characteristics, audit complexity, bank size, audit firm size, audit risk, and audit quality. The study emphasizes that audit fees are of significant interest to both auditors and their clients, as they represent a cost to companies while reflecting the quality and reputation of the audit services. The research finds that various factors, including the size of the bank, the complexity of its operations, and the characteristics of the board and audit committee, play a crucial role in determining audit fees.

The existing studies on audit fee determinants in Ethiopia predominantly emphasize client-specific characteristics, such as size, complexity, and risk profile, as key factors influencing audit pricing. However, these studies often overlook the broader contextual and organizational aspects of the audit firms themselves. This creates a significant research gap, as the characteristics of the audit firms, such as their

size, reputation, resources, and operational complexity, also play a crucial role in shaping audit fee structures.

2.4.2 Audit risks

Audit risk, the risk that auditors may fail to detect material misstatements in a firm's financial statements, is a critical determinant of audit fee pricing. The higher the audit risk, the more effort and resources auditors must allocate to mitigate it, thereby increasing the audit fees charged.

Feng and Jeyaraj (2017) and Muhajir (2018) explore the relationship between audit risk and audit fees, emphasizing that higher audit risk leads to increased fees due to the additional effort and resources required to mitigate potential liabilities. The audit risk is separated into three components, inherent risk, control risk and detection risk. Auditors do consider the audit risk in determining audit fees and higher risks related to higher audit fees. According to theoretical arguments, if audit risk is high, auditors should spend more efforts. At the same time for the undetected material misstatements, auditors tend to charge a risk premium to compensate their possible future loss. Thus, both an increase in audit efforts and risk premiums contribute to the rising of audit pricing. As for the empirical results of these paper, strong empirical evidence has found to suggest that the inherent risk and control risk have positive influence on audit fees. However, it has not found any proper measures of detection risk and does not provide any evidence on the relation between detection risk and audit fees.

In Ethiopia, research on audit fee determinants has been limited in scope, focusing primarily on the banking and insurance sectors while neglecting the role of audit firms in pricing strategies. There is a notable gap in analyzing specific risk types such as inherent, control, and detection risks in determining audit fees.

2.4.3 Auditor's Reputation, Size and Resource

Auditor's reputation, size, and resources are crucial factors influencing audit fee pricing. Larger audit firms with strong reputations and greater resources tend to charge higher fees, as they can offer higher-quality services and a greater level of assurance.

According to Kikhia, H.Y. (2014) study examines the determinants of audit fees in Jordan and presents audit fees are positively correlated with the size of the auditee, measured by the natural logarithm of total assets, consistent with findings in other countries and higher profitability of the audit client is associated with higher audit fees, possibly due to the perception of “deeper pockets.”. Moreover, firms audited by Big Four auditors incur significantly higher fees than those audited by domestic audit firms in Jordan. However, Companies with higher financial risk tend to pay lower audit fees.

In the study by Liu (2017), the results show that audit clients consider both the characteristics of the audit firm and the individual qualities of auditors when selecting audit services. Clients are willing to pay higher audit fees for auditors who provide "high quality" signals. Therefore, audit firms should focus on enhancing the professional education and on-the-job training of auditors, as well as developing industry expertise, to improve audit quality and achieve higher audit fees. Moreover, the study suggests that audit firms should improve the disclosure of individual auditors' characteristics. Currently, firms typically disclose only brief information, such as the firm's overall ranking. However, audit clients value individual auditors and are willing to pay varying audit fees based on their characteristics. Greater transparency in disclosing individual auditor information will reduce clients' search costs and help them select the most suitable audit services more efficiently.

Existing studies in Ethiopia predominantly focus on client-specific factors, with minimal attention given to how audit firm size, resource availability, and reputation influence audit fee determination. The unique impact of these firm-level characteristics remains underexplored.

Although auditor firm size and resource availability are significant determinants of audit fee pricing in developed economies, their impact appears less pronounced in emerging markets such as Ethiopia, where the audit market is characterized by the prevalence of small- and medium-sized practices.

2.4.4 Market Competition

Market competition and economic conditions are essential determinants of audit fee pricing. Competitive market conditions and economic factors, such as inflation and economic growth, significantly affect the pricing of audit services, influencing both the demand and supply sides of the audit market.

Chui (2015) explore the relationship between product market competition and audit fees, focusing on the manufacturing sector. Their study reveals that firms in more competitive industries tend to face higher audit fees due to increased audit risk, driven by factors such as financial instability, aggressive accounting practices, and operational challenges. They also find that within industries, firms with greater product market power pay lower audit fees. The results are robust across various sensitivity tests, including alternative econometric models and changes in governance.

Urhoghide, R.O. and Izedonmi, F.O.I. (2015) investigate the determinants of audit fees in Nigeria, highlighting the significant influence of audit client characteristics, audit firm characteristics, and corporate governance on audit fee levels. The study suggests that the current market framework for setting audit fees may not adequately address the cost uncertainties auditors face, as their net income is dependent on the fees paid by clients. Furthermore, the study raises concerns that the fear of losing clients and associated revenues could compromise auditor independence.

In Ethiopia, the dynamics of market competition and economic conditions also influence audit fee pricing. Assefa (2019) found that firms in Ethiopia tend to negotiate lower fees in a competitive market, especially when there are multiple audit firms competing for clients in the same industry. However, firms in less competitive industries or sectors with fewer audit firms available tend to face higher audit fees. Economic conditions, such as inflation, have also been found to impact audit fee levels, with rising inflation often leading to increased audit fees due to higher operational costs for audit firms. Abate and Abebaw (2020) further confirmed that during periods of economic instability, firms are more likely to negotiate audit fees down, while during periods of economic growth, demand for auditing services increases, pushing audit fees up. Mekonnen and Hussen (2021) also found that economic conditions, particularly in growing sectors such as telecommunications and finance, lead to higher audit fees as firms in these sectors require more complex and frequent audits.

Existing studies have not thoroughly explored how market competition influences audit fee structures in Ethiopia. The impact of competitive pressures, particularly how they affect pricing decisions among audit firms of different sizes, remains underexplored. Moreover, the effect of market competition on audit fees in industries or sectors that require IFRS or IPSAS-based reporting has not been sufficiently analyzed. Given that these standards impose higher reporting requirements, it would be valuable to investigate how competitive pressures in sectors that adopt IFRS or IPSAS influence audit pricing strategies.

2.4.4 Audit Regulation and Industry determinants

The implementation of rigorous auditing standards and regulatory requirements (International Standards on Auditing (ISA) or Public Company Accounting Oversight Board (PCAOB) standards) increases the complexity and the time required to complete audits, thus influencing audit fees. In countries with more stringent regulations, audit firms may charge higher fees to cover the increased compliance costs. For example, the introduction of IFRS or Sarbanes-Oxley Act in the United States has affected audit fee structures due to the increased responsibilities and risks for auditors. Moreover, strong corporate governance frameworks are associated with better audit quality and higher fees, as these frameworks often require more detailed and rigorous audits. Institutional factors, such as the development of accounting and auditing bodies (ACCA, AICPA), also influence the pricing of audit services by creating norms and expectations regarding audit quality and firm professionalism.

PCAOB (2020) examines the relationship between audit market structure, audit quality, and fee determination. The report highlights the dominance of a few large firms in the market, such as the Big Four, which influences pricing and competition. Larger firms tend to charge higher fees due to their expertise and reputation. Regulatory frameworks, including PCAOB standards, increase audit costs by requiring compliance with rigorous guidelines. The study identifies challenges such as limited competition, risks to auditor independence, and barriers for smaller firms to compete effectively. The report suggests fostering competition and balancing regulatory requirements to enhance audit quality and fair pricing structures

In Ethiopia, there is no specific regulation or framework explicitly setting audit fee pricing. However, audit fees are influenced by several factors indirectly linked to existing regulations and professional guidelines. Ethiopian auditing regulations, such as the adoption of International Standards on Auditing (ISA) and national regulatory frameworks, lack in-depth examination regarding their influence on audit fee determination.

2.4.5 Empirical Insights on Audit Regulation and Institutional Developments in Ethiopia

Recent developments in Ethiopia's audit regulatory environment highlight significant institutional reforms aimed at strengthening the accounting profession. In November 2024, the Ethiopian government established the Accounting Professionals Institute to address the shortage of qualified accountants and

enhance the adoption of International Financial Reporting Standards (IFRS). This initiative supports the country's evolving financial infrastructure, including preparations for its first stock exchange, and aims to improve financial transparency and investor confidence.

Additionally, the Accounting and Auditing Board of Ethiopia (AABE) ratified a new Professional Code of Ethics in 2024. The code emphasizes core ethical principles—such as integrity, objectivity, professional competence, confidentiality, and professional behavior—and promotes accountability and trustworthiness within the profession. Continuous training and awareness programs are planned to ensure effective implementation.

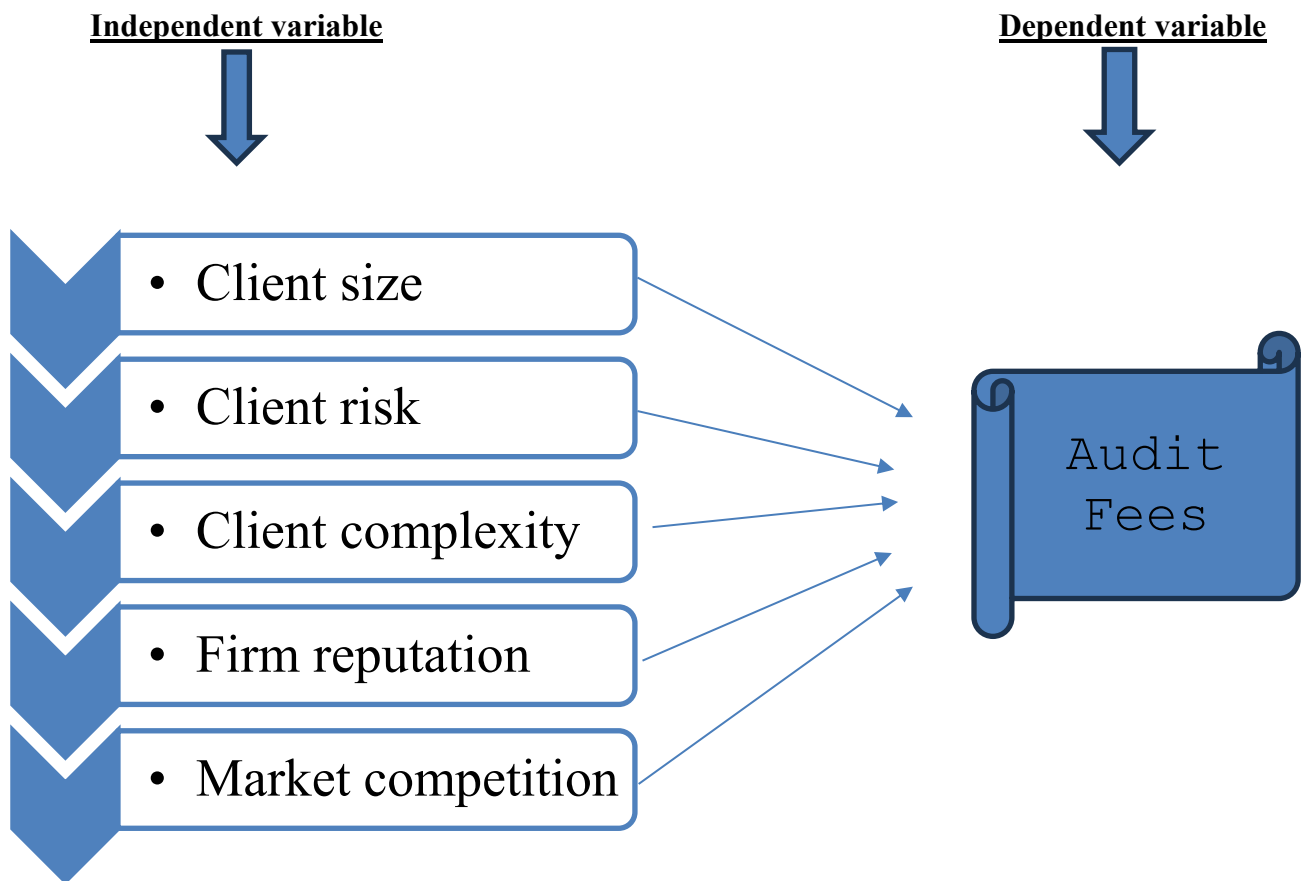
These regulatory advancements represent critical empirical evidence of the evolving audit environment in Ethiopia. They are expected to impact audit quality and fee structures by introducing higher compliance costs, strengthening professional standards, and fostering greater transparency and accountability in the financial sector.

2.5 Conceptual framework

A conceptual framework is a network of interconnected concepts that together offer a comprehensive understanding of a phenomenon (Jabareen, 2009). It outlines the key factors, constructs, or variables and the presumed relationships among them, as noted by Miles & Huberman (cited in Ngulube, Mathipa & Gumbo, 2015).

The conceptual framework on the determinants of audit fee pricing in Ethiopian audit firms aims to systematically explore the various factors influencing audit fees within the Ethiopian context. This framework integrates three key categories of determinants: client-related factors, auditor-related factors, and market competition. Client-related factors encompass the size, complexity, and risk profile of the client, which can significantly influence the resources required for an audit and, consequently, the fee charged. Auditor-related factors include the firm's reputation, experience, and the expertise of its auditors, which are essential in determining the quality and scope of audit services. Finally, market competition examines the impact of the competitive landscape, particularly the presence of both small- and medium-sized practices (SMPs) and larger audit firms, which can affect pricing strategies due to price sensitivity and competitive pressures.

Conceptual Framework Diagram:



CHAPTER THREE

RESEARCH METHODOLOGY

This chapter presents the research methodology that was employed in conducting the study. It outlines the study area, research design, research approach, population and sample, data sources and types, data collection procedures, methods of data analysis, and ethical considerations.

3.1 Description of the Study Area

The research is focus on external audit firms operating in Ethiopia. The country is home to 224 chartered certified accountants and authorized auditors who provide auditing services across various sectors. These professionals contribute to the growing auditing industry in Ethiopia, where local firms operate to serve businesses, government entities, and other organizations.

3.2 Research Design

Accordingly, from different types of research designs explanatory and descriptive type of research design is employed for this study for the realization of intended objectives. Descriptive type of research, according to Creswell (1994), is a technique of gathering information about the existing condition. The descriptive research attempts to describe, explain and interpret conditions of the present i.e. “what is”. The purpose of a descriptive research is to examine a phenomenon that is occurring at a specific place(s) and time. Descriptive research is concerned with conditions, practices, structures, differences or relationships that exist, opinions held, processes that are going on or trends that are evident. So, this study used descriptive research design to identify the determinants of audit fee pricing in Ethiopian audit firms. On the other hand, explanatory research designs, emphasis on studies of the discovery of ideas and insights. According to C.R. Kothari (1990), As such the research design appropriate for such studies to be flexible enough to provide opportunity for considering different aspects of a problem under study. Inbuilt flexibility in research design is needed because the research problem, broadly defined initially, is transformed into one with more precise meaning in exploratory studies, which fact may necessitate changes in the research procedure for gathering relevant data. The researchers will use descriptive research design. According to (Kotari, 2004) descriptive research studies are those studies which are concerned with describing the characteristics of a particular situation. Thus, the researchers will use this method to describe, explain, and interpret the challenges and opportunities of external auditing. According to (Polit & Hungler, 1999) this

type of research describes what exists and may help to uncover new facts and meaning. The purpose of descriptive research is to observe, describe, and document aspects of a situation as it naturally occurs.

The research followed a quantitative approach, relying exclusively on structured Likert-scale questionnaires as the primary data collection instrument. This allowed for the collection of standardized, numerical data that could be analyzed using descriptive statistics, correlation, and regression analysis. The structured format of the questionnaire ensured consistency in responses, facilitating the identification of patterns and relationships among variables.

Given the nature of the study focusing on measurable determinants and professional perceptions within Ethiopian audit firms the use of a quantitative, descriptive, and explanatory research design is both methodologically sound and contextually appropriate. This design enables the researcher to both describe current audit fee practices and explain the underlying factors influencing pricing decisions.

3.3 Research Approach

There are three approaches to conduct any research: Qualitative, Quantitative and Mixed approaches (Creswell 2009). Quantitative research is a means for testing objective theories by examining the relationship among variables. On the other hand, qualitative research approach is a means for exploring and understanding the meaning individuals or groups ascribe to a social or human problem with intent of developing a theory or pattern inductively. Finally, mixed methods approach is an approach in which the researchers emphasize the research problem and use all approaches available to understand it. A combination of qualitative and quantitative method is often the best way of handling research questions through triangulation (Russel, 2005 cited in Ahmed, 2005). Hence, endeavors were made to utilize the advantages of each method.

However, this study adopts a quantitative research approach exclusively, relying on primary data collected through structured Likert-scale questionnaires. The quantitative method allows for systematic measurement and statistical analysis of external auditors' perceptions on the determinants of audit fee pricing in Ethiopian audit firms. Using Likert-scale items enables the collection of standardized numerical data, facilitating objective analysis of relationships between key variables such as client size, client risk, client complexity, auditor reputation, and market competition.

By focusing solely on the quantitative approach, the study benefits from the ability to manage a larger number of respondents and apply rigorous statistical techniques to test hypotheses, thereby ensuring reliable and generalizable results within the Ethiopian audit context.

3.4 Population and sample

The subset of the whole population that the researchers are interested in surveying is known as sample, and the suitable selection of sample is important for the reliability of the research (Herawaty et al., 2021). Regarding to these (Li et al., 2018) noted that, sampling refers to drawing a sample or selecting a subset of elements from a Sampling Unit population. The design of a sampling strategy is an important issue for a research study and it can be a powerful tool for accurately measuring opinions and characteristics of a population. The main focus of this study is to understand the determinants of audit fee pricing in Ethiopian audit firms. According to the AABE, currently there are 224 Chartered Certified Accountants and Authorized Audit Firms operating in Ethiopia renewed in 2023/24.

The determination of sample size is resolved by means of Yamane (1967) sampling formula with 95 percent confidence level. Populations for quantitative data collection for this study are external audit firm in Ethiopia the case of selected audit firms. The total populations of external auditors' firms are 224. The firms are structured as sole proprietorships, partnerships, and limited liability partnerships, numbering 204, 13, and 7, respectively.

To calculate the sample size Yamane (1967) provides a simplified formula. Based on this formula confidence level is 95% and level of precision is 5%, and the marginal error e was limited to 0.05. Where e^2 is the marginal error.

$$n = \frac{N}{1+N(e)^2} \quad \text{Formula (Yamane, 1967)}$$

n - The sample size

N - The population size

e - The acceptable sampling error

** 95% confidence level and $p = 0.5$ are assumed*

Using this formula

$$n = \frac{N}{1 + N(e)^2}$$

Applying this formula to the population of 224 audit firms, a sample size of 170 was selected using simple random sampling techniques. The questionnaires were distributed to Principals, Partners and Audit Managers within the selected firms. The study received 145 completed responses, representing an 85.3% response rate, which is considered sufficient for reliable data analysis.

3.5 Data Source and Type

This study utilizes primary sources of data. The primary data were collected through structured questionnaires specifically designed to capture relevant insights from audit professionals regarding the determinants of audit fee pricing in Ethiopian audit firms. These questionnaires consisted of close-ended items, primarily based on a five-point Likert scale, allowing for standardized and quantifiable responses suitable for statistical analysis. This approach ensured consistency across respondents and facilitated efficient data collection and interpretation.

3.6 Data collection procedures

Primary data were gathered through structured questionnaires developed in line with the research objectives. The items were adapted from existing validated studies and designed using a five-point Likert scale. This allowed for standardized, quantifiable responses suitable for statistical analysis. The questionnaires were distributed to audit professionals across selected Ethiopian audit firms. No interviews or open-ended questions were included, as the study followed a fully quantitative approach.

3.7 Data analysis plan

The data analysis for this study was conducted using Statistical Package for the Social Sciences (SPSS) version 20, which is widely utilized for social science research due to its robust statistical tools and ease of handling survey data. The primary objective of this analysis was to explore and statistically validate

the relationship between selected determinants client size, audit risk, audit complexity, auditor reputation, and market competition and the audit fee pricing among Ethiopian audit firms.

3.7.1 Data Coding and Preparation

Responses from the structured Likert-scale questionnaires were first coded numerically to facilitate quantitative analysis. Each item on the Likert scale (ranging from Strongly Disagree = 1 to Strongly Agree = 5) was transformed into a corresponding numeric code. These coded responses were then entered into SPSS for further analysis. Missing data, if any, were treated through listwise deletion to ensure the integrity of the dataset.

3.7.2 Descriptive Analysis

To provide a general overview of the dataset, descriptive statistics were computed for all variables. This included:

- Frequencies and percentages to describe categorical demographics (e.g., position, education level, experience).
- Means and standard deviations to summarize the central tendency and dispersion of the Likert-scale responses.

These descriptive results helped to understand the respondent profile and the distribution of responses for each determinant.

3.7.3 Correlation Analysis

Pearson correlation analysis was used to examine the bivariate relationships between each independent variable and the dependent variable (audit fee pricing). This analysis helped to determine the strength and direction of the linear relationships, and served as a preliminary check before regression.

3.7.4 Multiple Linear Regression Analysis

The core analytical method used was Multiple Linear Regression (MLR), aimed at identifying the combined effect of the independent variables on audit fee pricing. The general form of the regression model is specified as:

$$AF = \beta_0 + \beta_1 CS + \beta_2 CR + \beta_3 CC + \beta_4 AR + \beta_5 MC + \varepsilon$$

Where:

- AF = Audit Fee Pricing (dependent variable)

- CS = Client Size
- CR = Client Risk
- CC = Client Complexity
- AR = Auditor Reputation
- MC = Market Competition
- β_0 = Intercept
- $\beta_1, \beta_2, \dots, \beta_5$ = Regression coefficients
- ε = Error term

3.9.5 Assumption Testing

Before interpreting the regression results, standard assumptions of MLR were tested to ensure the model's statistical validity:

- Linearity: Scatterplots and partial regression plots were examined to verify a linear relationship between independent and dependent variables.
- Normality of Residuals: The normal probability plot (P-P plot) and the Shapiro-Wilk test were used to assess whether residuals followed a normal distribution.
- Homoscedasticity: Residuals versus fitted value plots were checked to ensure constant variance of errors.
- Multicollinearity: The Variance Inflation Factor (VIF) and Tolerance values were assessed. VIF values below 10 and Tolerance above 0.1 were considered acceptable.
- Independence of Errors: The Durbin-Watson statistic was checked, with values between 1.5 and 2.5 considered indicative of no autocorrelation.

3.9.6 Model Fit and Significance

The model's overall explanatory power was assessed using:

- R-squared (R^2) and Adjusted R^2 , which indicate the proportion of variance in audit fee pricing explained by the predictors.
- ANOVA F-test, to determine if the model was statistically significant as a whole.
- Individual significance testing (t-tests), to assess the unique contribution of each independent variable.

3.8 Ethical considerations

This study involved human participants specifically, external auditors—therefore, strict ethical standards were maintained throughout the research process. Participation was entirely voluntary, and informed consent was obtained from all respondents after clearly explaining the purpose, objectives, and significance of the study. Participants were assured that their responses would remain confidential and anonymous; no personal identifiers or firm-specific names were collected or disclosed. The data gathered was used solely for academic purposes and handled with strict confidentiality. Furthermore, the research ensured that no harm physical, psychological, or reputational was inflicted on participants or their organizations during the study.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

This chapter presents and analyzes the data collected through a structured questionnaire designed to examine the determinants of audit fee pricing in Ethiopian audit firms. The questionnaire was distributed to practitioners working in the audit profession, including Principals, Partners, and Audit Managers across various licensed audit firms in Ethiopia.

The questionnaire which is a five-point Likert scale (Strongly disagree to strongly agree) was used to tap the responses through. The data collected from the respondents was coded, entered, and analyzed using Statistical Package for the Social Sciences (SPSS). Both descriptive and inferential statistical techniques were employed to address the research objectives and test the underlying assumptions. The responses were analyzed using frequency distributions, means, standard deviations, correlation matrices, and multiple regression analysis.

4.1 DEMOGRAPHIC CHARACTERISTICS

4.1.1. Response rate

The total population of certified audit firms in Ethiopia is 224. To determine the appropriate sample size, Yamane's (1967) formula for sample size calculation was applied. The formula suggested a minimum sample size of approximately 145 respondents at a 95% confidence level and a 5% margin of error.

However, due to the small overall population size and in an effort to enhance statistical reliability, a larger sample of 170 respondents was deliberately selected using simple random sampling techniques.

This approach also accounts for potential non-responses and increases the robustness of the analysis.

Structured questionnaires were distributed to Partners, Principals, and Audit Managers within these firms' individuals directly involved in audit planning and fee decisions. From the 170 questionnaires distributed, 145 valid responses were received, yielding a response rate of 85.3%. This high response rate is considered excellent for social science research and ensures the findings are both representative and reliable.

4.1.2 Educational level

From the respondents' perspective, a significant majority (92.7%) hold the ACCA qualification, indicating that most professionals in the field value or are required to attain international certification. Only a few

respondents reported holding a Master's Degree (5.5%) or a Bachelor's Degree (1.8%), suggesting that academic qualifications alone may be considered less sufficient compared to professional credentials in the audit profession in Ethiopia.

4.1.3 Job position

Respondents are mainly composed of Audit Managers (46.4%), with Partners (29.1%) and Principals (24.5%) also well represented. This implies that the data captures the perspectives of those who are highly engaged in the actual planning, supervision, and management of audit work, making their views on audit fee determination particularly relevant and grounded in practical experience.

4.1.4 Audit experience

A large proportion of respondents (47.3%) reported having 11–20 years of audit experience, while 30.9% have less than 10 years, and 21.8% have more than 21 years. This range of experience among respondents reflects a mature workforce, with many having significant exposure to audit practices and the factors that influence audit fee decisions.

4.1.5 Audit clients served

Most respondents (82.7%) indicated that they serve fewer than 100 audit clients, with only 17.3% serving 101–200 clients, and none serving more than 201. This suggests that, according to respondents, Ethiopian audit firms generally handle a limited number of clients, which may influence audit workload, pricing flexibility, and resource allocation.

4.1.6 Legal structure

Respondents reported that their firms are primarily organized as sole proprietorships (62.7%), followed by partnerships (20%) and limited liability partnerships (17.3%). This reflects the respondents' view that traditional ownership structures still dominate the profession, though there is a growing presence of more formalized legal structures such as LLPs.

4.1.7 Firms' operation in years

According to the respondents, many audit firms are relatively new, with 47.3% having operated for less than 10 years, 30.9% for 11–20 years, and 21.8% for more than 21 years. This indicates that from the

respondents' perspective, the audit sector in Ethiopia includes a mix of both emerging and established firms, each potentially facing different challenges in setting and negotiating audit fees.

Table 4.1 Demographic characteristics description

Variable	Category	Frequency (n)	Percentage (%)
Educational Level	ACCA	102	92.70%
	Master's Degree	6	5.50%
	Bachelor's Degree	2	1.80%
Job Position	Principal	27	24.50%
	Partner	32	29.10%
	Audit Manager	51	46.40%
Audit Experience	Less than 10 years	34	30.90%
	11–20 years	52	47.30%
	More than 21 years	24	21.80%
Audit clients served	Less than 100 years	91	82.70%
	101–200 years	19	17.30%
	More than 201 years	0	0.00%
Legal Structure	Sole proprietorship	69	62.70%
	partnership	22	20.00%
	Limited liability Partnership	19	17.30%
Firms' operation in years	Less than 10 years	52	47.30%
	11–20 years	34	30.90%
	More than 21 years	24	21.80%

Source: Analysis of survey data 2025,

4.2 RELIABILITY TEST

Reliability analysis is a critical component in assessing the internal consistency and stability of measurement instruments used in research. In this study, data were collected using structured questionnaires based on a Likert scale, a widely accepted tool for measuring attitudes, perceptions, and

behaviors (Likert, 1932). The scale used ranged from 1 (Strongly Disagree) to 5 (Strongly Agree), enabling respondents to express varying degrees of agreement or disagreement with a series of statements.

To evaluate the internal consistency of the Likert-scale items, Cronbach's alpha was employed as the primary measure of reliability. According to Nunnally (1978), a Cronbach's alpha value of 0.70 or above is generally considered acceptable for research purposes. However, George and Mallery (2003) provide further interpretation: values above 0.9 are excellent, 0.8–0.9 are good, 0.7–0.8 acceptable, 0.6–0.7 questionable, 0.5–0.6 poor, and below 0.5 unacceptable.

This reliability test helps ensure that the items used to measure each construct in the study are internally consistent and suitable for further statistical analysis, such as regression or factor analysis. The results of the reliability analysis are presented and interpreted in the following section.

Table 4.2 Reliability Statistics		
Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
0.775	0.801	5

Source: Analysis of survey data 2025, using SPSS output

As indicated in Table 4.2, the Cronbach's Alpha for the five variables is 0.775, while the standardized value is 0.801. Based on the classification provided by George and Mallery (2003), reliability coefficients are categorized as follows: ≥ 0.90 (excellent), 0.80–0.89 (good), 0.70–0.79 (acceptable), 0.60–0.69 (questionable), 0.50–0.59 (poor), and below 0.50 (unacceptable). According to these benchmarks, the results fall within the acceptable range, with the standardized score nearing the threshold for good reliability. This indicates that the measurement instrument demonstrates adequate internal consistency and is thus appropriate for further data analysis.

4.3 DESCRIPTIVE STATISTICS

Descriptive statistics serve as a fundamental step in data analysis by summarizing and organizing the essential characteristics of the collected data. They provide a clear overview of the distribution, central tendency, and variability of variables, allowing researchers to understand the patterns and general trends within the dataset before conducting inferential analysis. In this study, descriptive statistical techniques such as frequencies, percentages, means, and standard deviations were employed to describe the demographic profile of respondents and key variables related to audit fee determinants. According to

Leech, Barrett, and Morgan (2015), a standard deviation less than 1 indicates low variability, between 1 and 3 suggests moderate variability, and above 3 reflects high variability among data points. This initial analysis aids in identifying data distribution, detecting potential outliers, and ensuring data suitability for subsequent statistical tests.

This section highlights how respondents perceived and evaluated each of these variables. Participants were asked to express their level of agreement with a series of statements related to these indicators using a five-point Likert scale, where 1 represented "Strongly disagree," 2 "Disagree," 3 "Neutral," 4 "Agree," and 5 "Strongly agree." The findings offer a clear picture of prevailing opinions and levels of consensus among auditors concerning the determinants of audit quality.

The mean, often referred to as the average, is a measure of central tendency that represents the typical or central value in a set of numbers. It is calculated by adding together all the values in a dataset and then dividing the total by the number of values.

Standard deviation is used to identify variability among the data points, with its square root reflecting the variance. It serves as an indicator of how accurately the mean represents the overall dataset. A small standard deviation, in proportion to the mean, suggests that the data points are clustered closely around the mean, indicating consistency in responses. Conversely, a larger standard deviation implies greater dispersion, meaning that the data points are spread further from the mean and that the mean may not reliably represent the data. In this context, a high standard deviation reflects a wide range of opinions among respondents, while a low standard deviation indicates that responses were relatively similar and closely aligned.

4.3.1 Range of Interpreting Quantitative Data

The table below provides a numerical interpretation for average responses collected using a 5-point Likert scale, which is a common method in surveys for measuring agreement or disagreement with a statement.

Table 4.3.1: Range of Interpreting Quantitative Data

Score range	Interpretation
1.00-1.49	Strongly disagree
1.50-2.49	Disagree
2.50-3.49	Neutral
3.50-4.49	Agree
4.49-5.00	Strongly agree

Source: J. R. Lindner, N. J. Lindner (2024)

Table 4.3.2 Response Summary on Client Size

No.	Statement	Respondents' answer levels					N	Mean	Standard deviation
		1	2	3	4	5			
		SD	D	N	A	SA			
1	Client size (in terms of total assets or revenue) significantly affects audit fee pricing.	0	3	3	60	79	145	4.48	0.647
2	Larger clients generally require more audit effort, justifying higher fees.	0	4	8	63	70	145	4.37	0.716
3	The number of employees at the client organization affects the audit fee.	4	11	18	71	41	145	3.92	0.980
4	Clients with many daily transactions are usually charged higher audit fees.	0	4	9	74	58	145	4.28	0.704
5	The size of the client's accounting/finance department influences the audit effort required.	0	4	32	44	65	145	4.17	0.869

Source: Analysis of survey data 2025, using SPSS output

Based on the presented table 4.3.2, the analysis of the responses reveals that client size is widely regarded as a significant determinant of audit fee pricing by the respondents. The highest level of agreement is observed in the belief that client size, in terms of total assets or revenue, significantly affects audit fees (mean = 4.48), indicating strong consensus that larger clients require higher audit fees. This is closely supported by the view that larger clients generally demand more audit effort, with a mean of 4.37, reflecting confidence in the additional time and resources necessary for auditing larger organizations.

Respondents also broadly agree that clients with a high volume of daily transactions usually incur higher audit fees (mean = 4.28), suggesting that transaction complexity is a key driver of audit effort. Additionally, the size of the client's accounting or finance department is recognized as influencing audit procedures (mean = 4.17), showing that internal organizational structure plays a role in determining audit workload. The number of employees at the client organization is also seen as a relevant factor (mean = 3.92), though this item displays relatively more variation among responses, as indicated by a higher standard deviation (0.980). This suggests that while respondents generally agree on the importance of workforce size, they may differ slightly on the extent of its impact compared to other client size indicators.

Overall, the analysis indicates strong support for the idea that client size directly influences audit fee pricing through its effect on audit effort, complexity, and scope. These findings align with established empirical

studies which consistently report a positive relationship between client size and audit fees, emphasizing that larger and more complex clients typically demand more extensive audit work, justifying higher fees.

Table 4.3.3 Response Summary on Client Risk

No.	Statement	Respondents' answer levels					N	Mean	Standard deviation
		1	2	3	4	5			
		SD	D	N	A	SA			
1	Clients with higher financial risks (such as low liquidity or poor profitability) are associated with higher audit fees.	0	27	31	37	50	145	3.76	1.120
2	Operational risks, including complex business operations and regulatory compliance issues, lead to increased audit effort and higher fees.	0	2	32	35	76	145	4.28	0.854
3	The client's financial condition plays a significant role during audit fee negotiations.	3	17	26	40	59	145	3.93	1.116
4	Frequent changes in key management positions at the client organization increase the audit risk and influence audit fee levels.	1	5	35	38	66	145	4.12	0.942
5	Effective internal control systems can reduce audit procedures, thereby influencing audit fee levels.	2	4	24	36	79	145	4.28	0.933

Source: Analysis of survey data 2025, using SPSS output

Based on the presented table 4.3.3, the analysis of the responses reveals that client risk factors are generally perceived to have a significant influence on audit fee pricing by the respondents. The highest level of agreement is observed for the belief that operational risks, such as complex business operations and regulatory compliance challenges, lead to increased audit effort and justify higher fees (mean = 4.28), indicating strong consensus on the importance of operational complexity in audit pricing. This view is equally supported by the perception that effective internal control systems can reduce the extent of audit procedures and thereby influence audit fees (mean = 4.28), suggesting that when clients have strong controls, auditors can perform less detailed testing, which may result in lower fees.

Respondents also largely agree that frequent changes in key management positions at the client organization increase audit risk and impact audit fee levels (mean = 4.12). This reflects a shared understanding that management instability may introduce higher audit risks, requiring more rigorous audit work. Similarly, the client's financial condition is seen as playing an important role during audit fee

negotiations (mean = 3.93), showing that the financial health of the client is considered when determining audit fees. Meanwhile, clients with higher financial risks—such as low liquidity or poor profitability—are generally associated with higher audit fees (mean = 3.76), although responses to this item show the highest variability (standard deviation = 1.120), suggesting some differing views on the degree to which financial risk consistently drives audit fee increases.

Overall, the analysis indicates that audit fees are strongly influenced by both operational and financial risk factors, with particular emphasis on business complexity, management stability, and internal control strength.

Table 4.3.4 Response Summary on Client Complexity

No.	Statement	Respondents' answer levels					N	Mean	Standard deviation
		1	2	3	4	5			
		SD	D	N	A	SA			
1	A client's business complexity (e.g., multi-branch operations, international presence, or complex structures) significantly increases audit fees.	1	4	10	45	85	145	4.44	0.798
2	Diversified business activities or product lines require broader audit coverage, which raises the audit fee.	1	1	5	64	74	145	4.44	0.665
3	A client's geographical dispersion (e.g., operations in multiple locations or countries) results in higher audit fees due to logistical and coordination demands.	1	4	9	61	70	145	4.34	0.776
4	Clients using sophisticated accounting information systems (e.g., ERP systems) require more audit effort, thus affecting audit fee pricing.	1	7	22	65	50	145	4.08	0.867
5	The need for specialized technical expertise (e.g., industry-specific standards or systems) due to client complexity contributes to increased audit fees.	0	1	4	51	89	145	4.57	0.586

Source: Analysis of survey data 2025, using SPSS output

Based on the presented table 4.3.4, the analysis of the responses reveals that client complexity is widely perceived as a major factor influencing audit fee pricing among the respondents. The highest level of

agreement is seen in the belief that the need for specialized technical expertise—such as industry-specific standards or systems—due to client complexity significantly contributes to increased audit fees (mean = 4.57). This indicates strong consensus that when clients operate in specialized or highly technical industries, auditors must dedicate more time and resources, justifying higher fees.

Similarly, respondents strongly agree that a client's business complexity, including multi-branch operations, international presence, or complex organizational structures, significantly raises audit fees (mean = 4.44). The same high level of agreement is observed for the statement that diversified business activities or multiple product lines require broader audit coverage, which in turn increases audit fees (mean = 4.44). These responses reflect a shared understanding that the scope and intricacy of a client's operations expand the audit work required.

Geographical dispersion, where clients operate in multiple locations or countries, is also widely viewed as a factor that raises audit fees due to the additional logistical challenges and coordination needs (mean = 4.34). While the mean is slightly lower, there is still strong agreement that clients using sophisticated accounting information systems, such as ERP platforms, require more audit effort and thus influence audit fee pricing (mean = 4.08). Although this factor is generally agreed upon, it shows a slightly broader variation in responses (standard deviation = 0.867), suggesting that the impact of advanced systems on audit fees may vary depending on system complexity or auditor familiarity.

Overall, the analysis indicates that the complexity of a client's business, operational structure, and technological environment is a key determinant of audit fee pricing.

Table 4.3.5 Response Summary on Auditors Reputation

No.	Statement	Respondents' answer levels					N	Mean	Standard deviation
		1	2	3	4	5			
		SD	D	N	A	SA			
1	Clients are more willing to pay higher audit fees to audit firms with strong local experience and a positive track record in the profession	2	14	13	51	65	145	4.12	1.020
2	An audit firm's adherence to professional ethics and reputation for integrity influence clients' willingness to pay higher fees.	1	21	18	43	62	145	3.99	1.096
3	An audit firm's compliance with International Standards on Auditing (ISA) and local regulatory requirements justifies higher audit fees.	0	20	4	55	66	145	4.15	1.009

4	Clients consider the qualifications and professional certifications of audit engagement team members when evaluating audit fees.	0	12	26	49	58	145	4.06	0.956
5	Clients perceive audit firms affiliated with international networks as more credible and are willing to pay higher fees for their services.	0	20	17	48	60	145	4.02	1.044

Source: Analysis of survey data 2025, using SPSS output

Based on the presented table 4.3.5, the analysis of the responses reveals that auditor reputation and qualifications are generally perceived to significantly influence audit fee pricing among the respondents. The highest level of agreement is found in the belief that an audit firm's compliance with International Standards on Auditing (ISA) and local regulatory requirements justifies higher audit fees (mean = 4.15), indicating strong confidence that technical compliance and regulatory alignment enhance the value of audit services and warrant premium pricing.

Respondents also strongly agree that clients are more willing to pay higher audit fees to audit firms with strong local experience and a positive professional track record (mean = 4.12). This shows that a firm's history of quality service and market familiarity increases its perceived value. Similarly, the qualifications and professional certifications of the audit engagement team are seen as important factors when clients evaluate audit fees (mean = 4.06), suggesting that clients place value on the expertise and credentials of the auditors who perform the work.

Additionally, clients are generally perceived to regard audit firms affiliated with international networks as more credible and are willing to pay higher fees for their services (mean = 4.02), highlighting the importance of global affiliation and brand reputation in influencing client decisions. The lowest mean, though still in agreement, is related to the audit firm's adherence to professional ethics and its reputation for integrity (mean = 3.99), which shows that while ethical standing and integrity matter, respondents perceive other factors—such as regulatory compliance and professional expertise—to have slightly stronger influence on audit fee decisions. The relatively higher standard deviations across these items suggest that there is some variation in how strongly different clients value these reputation and quality-related factors.

Overall, the analysis indicates that audit fees are significantly affected by the auditor's reputation, qualifications, regulatory compliance, and perceived credibility.

Table 4.3.6 Response Summary on Market Computation

No.	Statement	Respondents' answer levels					N	Mean	Standard deviation
		1	2	3	4	5			
		SD	D	N	A	SA			
1	Clients' sensitivity to audit fees in a competitive market influences audit firms to offer lower pricing strategies.	0	6	14	95	30	145	4.12	.687
2	Despite the competition among audit firms, lower audit fees are often a result of client sensitivity to price rather than market dynamics.	0	12	18	87	28	145	3.90	0.802
3	The lack of a regulated or standardized audit fee structure in Ethiopia contributes to significant variability in the fees charged by audit firms.	0	6	6	52	81	145	4.43	0.762
4	Increased market competition in Ethiopia has a negative impact on the profitability of audit engagements.	0	23	15	63	44	145	3.88	1.017
5	Clients in Ethiopia are often more concerned about audit fees than the quality of the audit service when selecting an audit firm.	0	6	6	95	38	145	4.14	0.673
6	Clients, particularly in the public sector, often prioritize price over audit quality, especially under tender-based selection.	0	10	19	74	42	145	4.02	0.837
7	The absence of strict enforcement by regulatory bodies results in inconsistent application of audit fee structures across audit firms.	3	3	8	84	47	145	4.17	0.791
8	Price undercutting (lowballing) is a common strategy among audit firms in Ethiopia to secure clients, despite potential impacts on audit quality.	0	3	19	76	47	145	4.15	0.720

Source: Analysis of survey data 2025, using SPSS output

Based on the presented table 4.3.6, the analysis of the responses reveals that market competition and pricing sensitivity play a significant role in shaping audit fee strategies in Ethiopia. The highest level of agreement is seen in the belief that the lack of a regulated or standardized audit fee structure in Ethiopia contributes

to significant variability in audit fees charged by firms (mean = 4.43), indicating strong consensus that the absence of pricing guidelines leads to inconsistent and often negotiable fees across the industry.

Respondents also strongly agree that the absence of strict enforcement by regulatory bodies results in inconsistent application of audit fee structures across audit firms (mean = 4.17), reinforcing the view that weak regulatory oversight exacerbates fee variability. Price undercutting (lowballing) is widely perceived as a common practice among Ethiopian audit firms to secure clients, despite concerns about its potential negative impact on audit quality (mean = 4.15), suggesting that competitive pricing pressures frequently drive firms to offer fees below sustainable levels.

Additionally, respondents agree that clients in Ethiopia, particularly those in the public sector and tender-based environments, often prioritize price over audit quality (means = 4.14 and 4.02 respectively). This reflects a market reality where price competition tends to outweigh considerations of audit service quality. Clients' general sensitivity to audit fees is also acknowledged as a key influence, with many respondents agreeing that fee sensitivity pushes audit firms to adopt lower pricing strategies (mean = 4.03) and that lower fees often result from client price sensitivity rather than broader market dynamics (mean = 3.90). Respondents further perceive that increased market competition negatively affects the profitability of audit engagements (mean = 3.88), although opinions on this are more varied as reflected by a higher standard deviation (1.017), suggesting some differing views about the extent of this profitability impact across different firms and contexts.

Overall, the analysis indicates that the Ethiopian audit market is heavily influenced by price competition, fee sensitivity, and the absence of standardized pricing guidelines, all of which contribute to significant fee variability and downward pressure on audit fees.

4.4 PARAMETRIC STATISTICAL ASSUMPTIONS

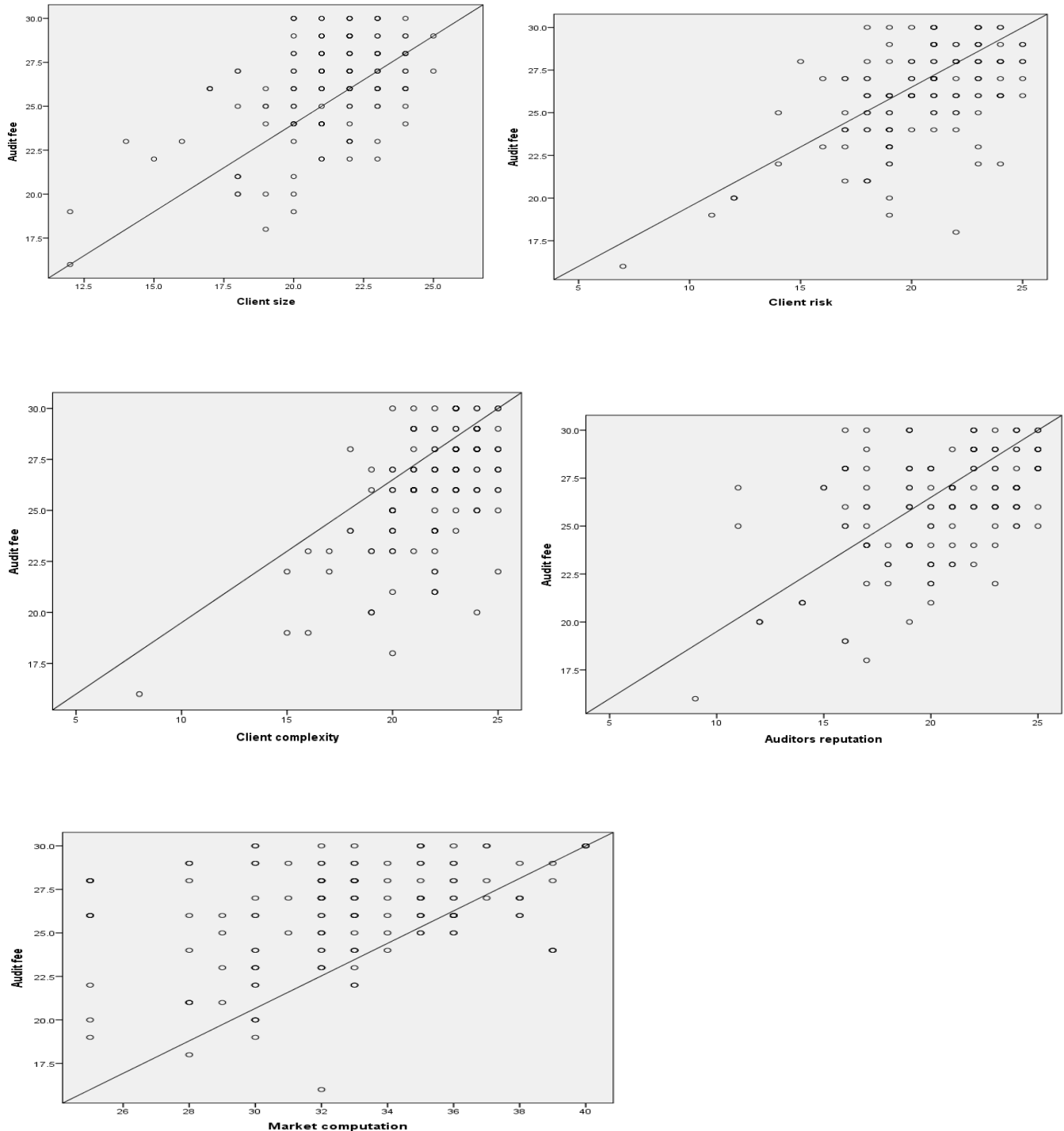
4.4.1 Linearity Test

According to Mool (2014), one of the key assumptions of the Classical Linear Regression Model (CLRM) is that there must be a linear relationship between the dependent variable and each of the independent variables. This assumption is satisfied when the regression model is linear in parameters (i.e., the β coefficients). Linearity ensures that changes in the independent variables result in proportional and predictable changes in the dependent variable.

To test for linearity, a visual inspection using scatter plots is commonly employed. By plotting each independent variable against the dependent variable, researchers can assess whether a linear pattern exists

or if there is evidence of curvature or a non-linear relationship. A straight-line trend in the scatter plot supports the linearity assumption, while systematic deviations may indicate the need for variable transformation or a different modeling approach.

4.4 Linearity Table



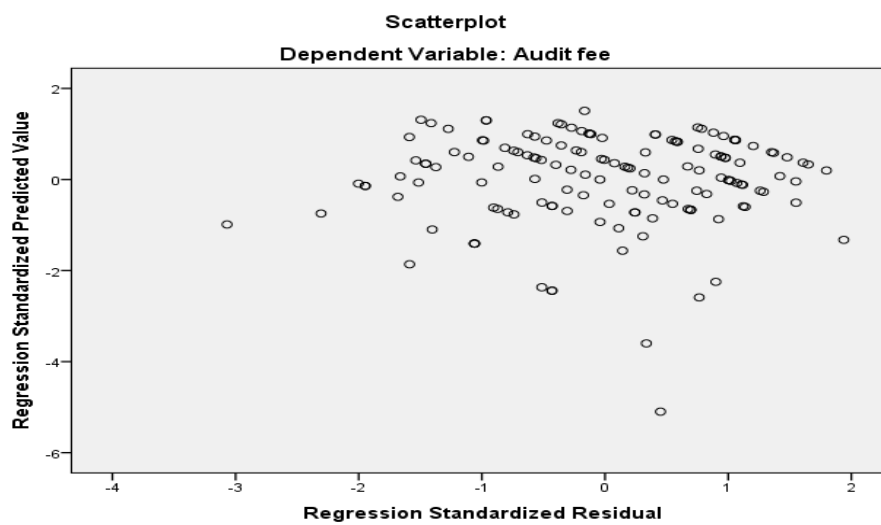
Source: Analysis of survey data 2025, using SPSS output

From the above graph 4.4, the scatter plot graph line shows straight line for each independent variable, this implies that the relationship between the dependent and independent variables are linear.

4.4.2 Homoscedasticity Test

One of the key assumptions of the classical linear regression model is homoscedasticity, which requires that the variance of the error terms remains constant across all levels of the independent variables. If this condition is violated, and the variance of the errors changes with the values of the predictors, the problem is known as heteroscedasticity. Heteroscedasticity can lead to inefficient estimates and invalid statistical inferences, such as biased standard errors and misleading significance tests.

4.5 Homoscedasticity Table



Source: Analysis of survey data 2025, using SPSS output

From the above graph, 4.5 shows the results of the homoscedasticity test, indicating that the variance of the residuals is constant across all levels of the independent variables, confirming that the assumption of homoscedasticity is met. This means that there is no evidence of heteroscedasticity in the regression model. Consequently, the standard errors of the estimated coefficients are reliable, ensuring the validity of hypothesis tests and confidence intervals. Therefore, the regression results can be interpreted with confidence, supporting the robustness of the model in explaining variations in the dependent variable.

4.4.3 Multicollinearity Test

Multicollinearity occurs when two or more independent variables in a regression model are highly correlated, which can distort the estimated coefficients and reduce the reliability of statistical inferences (Gujarati & Porter, 2009). It violates the classical linear regression assumption that independent variables should be mutually independent. High multicollinearity inflates the standard errors of the coefficients, making it difficult to determine the individual effect of each predictor on the dependent variable (Hair et al., 2010).

To detect multicollinearity, researchers typically examine Tolerance and Variance Inflation Factor (VIF) values. A tolerance value below 0.1 often signals multicollinearity concerns, while a VIF value exceeding 10 is generally considered indicative of serious multicollinearity, though some suggest a stricter cutoff of 5. Additionally, tolerance scores above 0.2 are usually viewed as acceptable to confirm the absence of multicollinearity.

4.6 Coefficients^a

Model	Collinearity Statistics	
	Tolerance	VIF
Client size	0.561	1.782
Client risk	0.503	1.987
Client complexity	0.573	1.746
Auditors' reputation	0.647	1.547
Market computation	0.949	1.054

a. Dependent Variable: Audit fee

Source: Analysis of survey data 2025, using SPSS output

From the above table, 4.6 shows the collinearity diagnostics for the independent variables indicate that multicollinearity is not a concern in this regression model. Specifically, the tolerance values for all variables range from 0.503 to 0.949, well above the critical threshold of 0.1 or even the more conservative 0.2 level, suggesting that each predictor retains a substantial amount of unique variance not explained by other variables.

Correspondingly, the Variance Inflation Factor (VIF) values range between 1.054 and 1.987, all well below the commonly accepted cutoff of 5 or 10, further confirming the absence of multicollinearity issues. These results imply that the independent variables Client size, Client risk, Client complexity, Auditors' reputation, and Market competition are sufficiently independent of each other, supporting the reliability of the coefficient estimates in predicting the dependent variable, Audit fee.

4.4.5 Normality Test

Normality is a key assumption in many parametric statistical analyses, ensuring that data or residuals are approximately normally distributed. Among various methods to assess normality, skewness and kurtosis are widely used numerical indicators that describe the shape of the distribution. Skewness measures the asymmetry of the distribution around the mean, while kurtosis reflects the peakedness or flatness compared to a normal distribution (Ghasemi & Zahediasl, 2012). In an ideally normal distribution, skewness and kurtosis values should be close to zero. Deviations from zero indicate departures from normality, with positive or negative skewness showing right or left asymmetry, respectively, and kurtosis values greater or less than zero indicating more peaked or flatter distributions.

To evaluate the significance of skewness and kurtosis, their respective values are often divided by their standard errors to calculate z-scores. Values within ± 1.96 suggest that the distribution does not significantly deviate from normality at the 5% significance level (Field, 2013). This method provides a straightforward numerical approach to confirm the normality assumption required for valid parametric testing.

4.7 Descriptive Statistics					
	N	Skewness		Kurtosis	
	Statistic	Statistic	Std. Error	Statistic	Std. Error
Client size	145	-1.445	.201	3.380	.400
Client risk	145	-1.180	.201	2.620	.400
Client complexity	145	-1.815	.201	6.777	.400
Auditors' reputation	145	-.773	.201	.231	.400
Market computation	145	-.214	.201	-.216	.400
Audit fee	145	-.885	.201	.641	.400

Source: Analysis of survey data 2025, using SPSS output

The normality of the variables was evaluated using skewness and kurtosis statistics, where skewness measures the asymmetry of the data distribution and kurtosis assesses its peakedness or flatness compared to a normal distribution. In this study, Client size, Client risk, and Client complexity demonstrated significant negative skewness, indicating a left-skewed distribution with a longer tail toward smaller values. The calculated skewness z-scores for these variables exceeded the ± 1.96 threshold, confirming a significant deviation from symmetry. Additionally, these variables exhibited substantially positive kurtosis values, reflecting leptokurtic distributions characterized by sharper peaks and heavier tails relative to a normal distribution. These findings indicate that these variables deviate from a perfect normal distribution. Conversely, variables such as Auditors' reputation, Market competition, and Audit fee showed skewness and kurtosis values nearer to zero, suggesting distributions closer to normality. Considering the moderate to large sample size of 145, the central limit theorem supports the use of parametric tests despite these deviations. Nevertheless, it is important to acknowledge these departures from normality and apply data transformation or robust statistical methods if strict adherence to normality assumptions is required for specific analyses.

4.5 INFERENTIAL ANALYSIS

Inferential statistical analysis was employed to examine the relationships between the dependent variable, audit fee pricing, and the selected independent variables: client size, client risk, client complexity, auditor's reputation, and market competition.

The primary objective of this analysis was to draw conclusions that extend beyond the immediate sample and generalize the findings to the broader population of audit firms operating in Ethiopia. By using statistical tools such as Pearson correlation and multiple regression analysis, the study aimed to test the significance and strength of associations among the variables.

The inferential results provide empirical evidence to support or refute theoretical assumptions regarding the determinants of audit fees. This approach enhances the robustness of the study's conclusions, allowing for the identification of which factors most strongly predict audit fee variations.

Ultimately, inferential analysis bridges the gap between sample observations and broader population-level implications, ensuring that the research contributes meaningful insights into audit pricing behavior in the Ethiopian context.

4.5.1. Correlation Analysis

The correlation between two variables measures the degree of linear association between them. If it is stated that the dependent variable and independent variables are correlated, it means that the dependent variable and independent variables are being treated in a completely symmetrical way. Thus, it is not implied that changes in explanatory variables cause changes in explained and vice versa. Rather, it is simply stated that there is evidence for a linear relationship between the two variables, and that movements in the two are, on average, related to an extent given by the correlation coefficient.

The value for this correlation coefficient ranged between negative one and positive one. Negative one correlation coefficient indicates perfect negative relationship between dependent variable and independent variables; and positive one correlation coefficient tells us perfect positive relation; while zero correlation coefficient implies that there is no relationship between the two variables.

The purpose of the correlation test in this particular study was to analyze the relationship between audit quality and its determinant factors considered in the model.

4.8 Correlations Table							
		Client size	Client risk	Client complexity	Auditors' reputation	Market computation	Audit fee
Client size	Pearson Correlation	1					
Client risk	Pearson Correlation	.548**	1				
Client complexity	Pearson Correlation	.581**	.531**	1			
Auditors' reputation	Pearson Correlation	.426**	.568**	.293**	1		
Market computation	Pearson Correlation	.104	.078	.203**	.118	1	
Audit fee	Pearson Correlation	.527**	.584**	.583**	.502**	.367**	1
	N	145	145	145	145	145	145

**. Correlation is significant at the 0.01 level (1-tailed).

Source: Analysis of survey data 2025, using SPSS output

4.5.1.1. Client Size and Audit Fee

The Pearson correlation coefficient between Client Size and Audit Fee is 0.527, which is statistically significant at the 0.01 level ($p = 0.000$). This indicates a moderate positive correlation, suggesting that as the size of the client increases, the audit fee also tends to increase. This aligns with the theoretical expectation that larger firms typically require more extensive audit procedures due to greater operational

complexity, more transactions, and increased audit risk, all of which contribute to higher audit costs. This result supports prior studies, such as Hay et al. (2006), who emphasized client size as a primary determinant of audit pricing.

4.5.1.2 Client Risk and Audit Fee

The Pearson correlation coefficient between Client Risk and Audit Fee is 0.584, significant at the 0.01 level ($p = 0.000$). This reveals a strong positive correlation, indicating that audit fees increase as perceived client risk rises. Higher-risk clients may require more in-depth audit procedures, extended testing, and additional verification work, leading to increased audit hours and higher fees. This finding is consistent with auditing theories and empirical research, such as Bell et al. (2001) and Choi et al. (2009), who observed that auditors incorporate risk premiums when pricing their services to cover potential litigation and reputational risks.

4.5.1.3 Client Complexity and Audit Fee

The correlation coefficient between Client Complexity and Audit Fee is 0.583, with a significant p-value of 0.000 at the 0.01 level. This also represents a strong positive relationship, implying that clients with more complex operations, such as diversified subsidiaries, international activities, or intricate financial reporting structures, tend to incur higher audit fees. The additional time, specialized expertise, and audit planning required for complex clients contribute to this relationship. This result supports the findings of Palmrose (1986) and Simunic (1980), who demonstrated that client complexity significantly increases the scope and cost of audit services.

4.5.1.4 Auditor's Reputation and Audit Fee

The Pearson correlation between Auditor Reputation and Audit Fee is 0.502, which is significant at the 0.01 level ($p = 0.000$). This indicates a moderate positive correlation, suggesting that auditors with stronger reputations—possibly due to firm size, market recognition, or perceived quality—are able to command higher fees. Clients may be willing to pay premium fees for reputable auditors due to the perceived assurance quality and credibility it brings to financial statements. This outcome aligns with the work of Francis (2004) and DeAngelo (1981), who argued that auditor reputation and quality differentiation influence audit pricing in competitive markets.

4.5.1.5 Market Competition and Audit Fee

The Pearson correlation coefficient between Market Competition and Audit Fee is 0.367, also statistically significant at the 0.01 level ($p = 0.000$). This shows a positive but weaker relationship, indicating that while competition may influence audit pricing, its effect is less pronounced compared to other variables such as client risk or complexity. In highly competitive audit markets, firms may be limited in how much they can charge, but competition still plays a role in shaping fee structures. This is in line with findings from Craswell et al. (1995), who suggested that market forces act as a constraint on audit fees, especially in environments with many providers and price-sensitive clients.

Overall, the correlation analysis confirms the theoretical expectations and provides empirical evidence from the Ethiopian audit market context. All five independent variables show statistically significant positive relationships with audit fees, suggesting their relevance in audit fee determination. This indicates that factors such as client size, complexity, risk, auditor reputation, and even market dynamics collectively shape audit pricing decisions.

4.5.2. Regression Analysis

To determine the most appropriate estimation technique for analyzing the panel data, the Hausman test was applied to decide between the fixed effects and random effects models. The test results confirmed that the random effects model was more suitable for this study. Consequently, the final regression was conducted using the random effects panel regression model, with the results summarized in Table 4.6. The independent variables in the model—client size, client risk, client complexity, auditor's reputation, and market competition—were measured using the Likert scale method, capturing respondents' perceptions on a standardized ordinal scale. This approach enabled the quantification of qualitative assessments and facilitated statistical analysis. The model's ability to explain variations in the dependent variable, audit fee pricing, was evaluated using goodness-of-fit statistics. Among these, the R-squared statistic is widely recognized as an effective measure, indicating the proportion of variance in audit fees explained by the model. The R-squared value ranges from 0 to 1, where values closer to 1 reflect a better fit between the model and the observed data, thus providing a straightforward measure of the model's explanatory power (Brooks, 2008).

4.9 Model Summary Table									
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.748 ^a	.559	.543	1.942	.559	35.255	5	139	.000

a. Predictors: (Constant), Market computation, Client risk, Client size, Auditors' reputation, Client complexity

Source: Analysis of survey data 2025, using SPSS output

Table 4.9 presents the summary statistics for the multiple regression model used to assess the impact of five independent variables, Client Size, Client Risk, Client Complexity, Auditor's Reputation, and Market Competition, on the dependent variable, Audit Fee.

The multiple regression model yielded an R value of 0.748, indicating a strong positive correlation between the combined independent variables—client size, client risk, client complexity, auditor reputation, and market competition—and the dependent variable, audit fee. According to conventional interpretation scales, an R value between 0.60 and 0.79 represents a strong correlation, confirming that these predictors collectively have a strong association with audit fee variations among Ethiopian audit firms.

The R Square value is 0.559, meaning that approximately 55.9% of the variation in audit fees is explained by the independent variables in the model. By standard interpretation, an R Square between 0.50 and 0.69 indicates substantial explanatory power, demonstrating that the client and auditor characteristics, alongside market competition, explain a significant portion of the audit fee variability.

The Adjusted R Square is 0.543, which slightly decreases from the R Square to account for the number of predictors and sample size. This value still falls within the substantial explanatory power range, reinforcing the model's robustness and suggesting that about 54.3% of the variance in audit fees can be reliably attributed to the studied factors after adjusting for model complexity.

The Standard Error of the Estimate is 1.942, which indicates the average deviation of the observed audit fees from the predicted values. While there is no fixed scale for this measure, a lower standard error relative

to the mean audit fee suggests the model predictions are reasonably precise and that residual errors are moderate.

Furthermore, the F-statistic is 35.255, with a p-value of 0.000, indicating the model is highly statistically significant at the 0.01 level. According to standard criteria, a p-value less than 0.01 confirms that the model explains a significant amount of the variation in audit fees, and the relationship observed is unlikely due to chance.

Overall, the regression model shows strong statistical validity and explanatory power, making it a robust framework for understanding audit fee determinants in the Ethiopian audit context. The strength of the R, R², and Adjusted R² values, combined with the significant F-statistic, underscores the relevance of client-specific characteristics and market factors in influencing audit pricing decisions. This foundation supports further analysis and policy implications for auditors and regulators in Ethiopia.

4.10 ANOVA^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	664.790	5	132.958	35.255	.000 ^b
	Residual	524.217	139	3.771		
	Total	1189.007	144			

a. Dependent Variable: Audit fee

b. Predictors: (Constant), Market computation, Client risk, Client size, Auditors' reputation, Client complexity

Source: Analysis of survey data 2025, using SPSS output

The Analysis of Variance (ANOVA) table provides crucial information about the overall significance of the regression model used to predict audit fees based on the selected independent variables: client size, client risk, client complexity, auditor's reputation, and market competition.

The Analysis of Variance (ANOVA) table evaluates the overall significance of the multiple linear regression model used to predict audit fees. The reported F-statistic is 35.255, with a p-value of 0.000, which is highly significant at the 1% level. This result provides strong statistical evidence to reject the null

hypothesis that all regression coefficients are equal to zero, confirming that at least one of the independent variables significantly influences audit fees.

The regression sum of squares (SSR) is 664.790, which represents the proportion of the variance in audit fees explained by the five predictors: client size, client risk, client complexity, auditor reputation, and market competition. The residual sum of squares (SSE) is 524.217, indicating the portion of variance not explained by the model. The total sum of squares (SST) is 1189.007, and the fact that the explained variation (SSR) exceeds the unexplained variation (SSE) supports the conclusion that the model has a good overall fit.

This significant F-test result confirms the collective relevance of the independent variables in explaining audit fee differences in the Ethiopian audit market. The findings align with established international literature (e.g., Hay et al., 2006; Simunic, 1980), reinforcing the notion that audit fee pricing is systematically influenced by identifiable client characteristics and market dynamics, rather than occurring randomly. These insights offer valuable implications for audit practitioners, regulatory bodies, and policymakers aiming to understand and manage audit pricing structures in Ethiopia.

4.11 Coefficients^a					
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.091	2.075		.526	.600
Client size	.160	.096	.126	1.673	.097
Client risk	.221	.075	.233	2.939	.004
Client complexity	.323	.088	.274	3.682	.000
Auditors' reputation	.168	.057	.205	2.925	.004
Market computation	.202	.046	.256	4.434	.000

a. Dependent Variable: Audit fee

Source: Analysis of survey data 2025, using SPSS output

The coefficients table 4.11 above presents the individual contribution of each independent variable, client size, client risk, client complexity, auditor's reputation, and market competition, to the prediction of the

dependent variable, audit fee. The table includes both unstandardized and standardized coefficients, along with the t-values and significance (p-values), which help in evaluating the statistical contribution of each predictor.

4.5.2.1 Client Size

The regression coefficient for Client Size is $B = 0.160$, with a standardized Beta of 0.126, t-value = 1.673, and p-value = 0.097. Although this indicates a positive relationship between client size and audit fee, the effect is not statistically significant at the 5% level, but it is marginally significant at the 10% level. Based on common academic standards ($p < 0.10$ = marginally significant, $p < 0.05$ = significant, $p < 0.01$ = highly significant), this suggests that while larger clients may tend to incur higher audit fees, the evidence is not strong enough to confirm this at stricter significance thresholds. This result partially aligns with the theoretical proposition that larger firms require more extensive audit procedures due to the volume of transactions and scope of operations, leading to increased audit effort and cost (Hay et al., 2006; Simunic, 1980).

4.5.2.2. Client Risk

The coefficient for Client Risk is $B = 0.221$, with a standardized Beta of 0.233, t-value = 2.939, and a p-value of 0.004. This relationship is statistically significant at the 1% level, indicating a moderate and reliable positive effect of client risk on audit fees. According to scale standards, this falls under strong evidence ($p < 0.01$). This finding aligns with the notion that auditor's factor in a risk premium when dealing with clients facing elevated financial or operational risks, as such audits demand more extensive procedures and professional judgment to address the increased likelihood of misstatements or legal exposure (Imeni and Alqahtani, 2025). Thus, the findings reinforce the relevance of risk-based pricing in the Ethiopian auditing context.

4.5.2.3. Client Complexity

Client Complexity shows the strongest effect on audit fee, with $B = 0.323$, standardized Beta = 0.274, t-value = 3.682, and p-value = 0.000, making it highly significant at the 1% level. Based on standard interpretation, this is statistically and practically significant, indicating that more complex clients — those with diversified operations, international branches, or complex accounting structures — incur higher audit costs. The high beta value shows that complexity explains a substantial portion of the variance in audit fees. This aligns well with audit theory, which argues that complexity increases audit effort and necessitates higher expertise and time, thereby justifying higher fees (Simunic, 1980; Hay et al., 2006).

4.5.2.4 Auditor's Reputation

The coefficient for Auditor's Reputation is $B = 0.168$, with a standardized Beta of 0.205, $t\text{-value} = 2.925$, and $p\text{-value} = 0.004$, indicating statistical significance at the 1% level. This suggests that audit firms with higher reputational standing — often associated with higher audit quality and brand trust — can command higher audit fees, consistent with the reputation premium theory. From a theoretical standpoint, reputable auditors signal credibility and financial statement reliability, allowing them to charge premium prices for their services (Francis, 1984). In the Ethiopian audit market, this finding implies that clients perceive higher audit value from well-established or renowned firms and are willing to pay accordingly.

4.5.2.5 Market Competition

Market Competition has a significant impact, with $B = 0.202$, standardized Beta = 0.256, $t\text{-value} = 4.434$, and $p\text{-value} = 0.000$, indicating high statistical significance ($p < 0.01$). Interestingly, the positive relationship suggests that greater market competition does not drive audit fees down, as traditionally theorized, but may reflect a differentiation-based competition in Ethiopia, where audit firms compete based on quality rather than price alone. This could mean that more competitive markets attract more capable auditors and clients seeking quality assurance, pushing audit fees upward. This contrasts with earlier assumptions of price-cutting behavior and aligns with emerging literature that considers competition in differentiated audit markets (DeAngelo, 1981).

From the coefficient analysis, client complexity, auditor reputation, and market competition emerge as statistically significant and practically meaningful predictors of audit fees in the Ethiopian context. Client size is marginally significant, while client risk does not show a significant effect in this model.

These results not only reflect the operational realities of Ethiopian audit firms but also align with global audit pricing literature. The findings imply that auditors and regulators should consider complexity and reputation-related attributes when evaluating audit pricing policies, and that a quality-differentiated competitive strategy might be in play rather than purely cost-driven competition.

4.6 SUMMARY AND COMPARISON OF HYPOTHESISED AND ACTUAL IMPACTS

In this study, five hypotheses were proposed regarding the relationship between key determinants and audit fee pricing. The hypothesized directions were based on established audit fee pricing theories and prior empirical evidence. The actual findings from the regression analysis both confirmed and refined these expectations.

H1.1 Effect of Client Size on Audit Fees

Hypothesis: It was hypothesized that client size would have a positive and significant effect on audit fees, as larger clients typically demand more audit effort.

Actual Impact: The results showed a positive relationship ($\beta = 0.126$), consistent with the hypothesis; however, the effect was marginally significant ($p = 0.097$). This suggests that while client size does influence audit fees, its impact in the Ethiopian audit market is somewhat weaker than anticipated, possibly due to other overriding factors such as risk and complexity.

H1.2 Influence of Client Risk on Audit Fees

Hypothesis: A positive and significant relationship was expected between client risk and audit fees, reflecting increased audit effort for higher-risk clients.

Actual Impact: The data confirmed this expectation strongly ($\beta = 0.233$, $p = 0.004$), indicating that auditors adjust fees upward as client risk increases, in line with risk-based pricing theory.

H1.3 Impact of Client Complexity on Audit Fees

Hypothesis: It was predicted that client complexity would significantly and positively affect audit fees, given the additional audit challenges involved.

Actual Impact: The findings supported this hypothesis robustly ($\beta = 0.274$, $p < 0.001$), showing that complexity is a key determinant of audit fee levels in Ethiopia.

H1.4 Role of Auditor Reputation in Audit Fee Determination

Hypothesis: The expectation was that auditor reputation would positively and significantly influence audit fees, as reputed firms command premium prices.

Actual Impact: This was confirmed ($\beta = 0.205$, $p = 0.004$), underscoring reputation's role as a valuable asset in fee negotiations and client perceptions of audit quality.

H1.5 Effect of Market Competition on Audit Fees

Hypothesis: The relationship between market competition and audit fees was hypothesized to be negative, assuming that higher competition would drive fees down.

Actual Impact: Contrary to this expectation, market competition showed a significant positive association with audit fees ($\beta = 0.256$, $p < 0.001$). This suggests a complex market dynamic where competition may encourage firms to differentiate their services or reflect specialized audit work that commands higher fees, highlighting a context-specific nuance in Ethiopia.

This comparison reveals that while most hypothesized relationships align well with the empirical results, the unexpected positive effect of market competition on audit fees offers new insights into local market conditions and warrants further exploration. Overall, the study confirms the relevance of classical audit fee determinants while also contributing contextual understanding specific to Ethiopian audit firms.

4.7 DISCUSSION OF RESEARCH FINDINGS

Discussion of findings is focused on the result of the above multiple regression result table, and based on the result, the effect of each explanatory variable on the financial performance of insurance companies in Ethiopia is discussed in the following part.

4.7.1 Client Size:

The analysis indicates that client size has a positive but marginally significant effect on audit fees ($\beta = 0.126$, $p = 0.097$). This suggests that larger clients tend to be associated with higher audit fees, although this relationship is weaker compared to other variables. The finding aligns with theoretical expectations and previous empirical studies, which argue that larger organizations generally require more extensive audit work due to the volume and complexity of their transactions, thereby increasing audit costs. However, the relatively lower significance level might imply that other factors beyond size, such as risk and complexity, have a stronger influence on fee determination in the Ethiopian context.

4.7.2 Client Risk:

Client risk is a significant positive predictor of audit fees ($\beta = 0.233$, $p = 0.004$). This result supports the risk-based audit pricing theory, where auditors charge higher fees for clients with elevated risk profiles due to the increased effort, resources, and potential liability involved in auditing such clients. The

significant impact of client risk suggests that auditors in Ethiopia are responsive to the risk characteristics of their clients and adjust fees accordingly, reflecting prudent audit practice and risk management.

4.7.3 Client Complexity:

Client complexity exhibits the strongest positive and statistically significant effect on audit fees ($\beta = 0.274, p < 0.001$). This finding is consistent with the notion that clients with more complex operations, organizational structures, or financial transactions require additional audit procedures, specialized expertise, and increased time commitment, all of which contribute to higher audit fees. The significance of this variable emphasizes that audit firms in Ethiopia recognize and price the challenges posed by client complexity effectively.

4.7.4 Auditor's Reputation:

Auditor reputation is also a significant factor influencing audit fees ($\beta = 0.205, p = 0.004$). A well-reputed audit firm can command premium fees, as clients perceive higher audit quality, reliability, and credibility associated with such firms. This finding aligns with international studies indicating that auditor reputation enhances bargaining power and fee-setting ability. It highlights the importance of reputation as a non-quantitative determinant in the Ethiopian audit market.

4.7.5 Market Competition:

Market competition has a significant positive relationship with audit fees ($\beta = 0.256, p < 0.001$). This might reflect that competitive markets stimulate audit firms to differentiate their services through quality or specialization rather than solely on price, allowing them to maintain or increase fees. Alternatively, this could indicate market segments where competition leads to more complex audits, justifying higher fees. This result underscores the role of the audit market environment in shaping fee structures in Ethiopia.

CHAPTER FIVE

SUMMARY, CONCLUSION, AND RECOMMENDATION

5.1 Summary

This research was conducted to examine and identify the key determinants influencing audit fee pricing within the context of Ethiopian audit firms. The study was grounded in both theoretical and empirical frameworks that recognize audit fees as a function of client-specific, auditor-specific, and market-specific factors. Specifically, the study investigated five independent variables: client size, client risk, client complexity, auditor reputation, and market competition, and how these factors influence the audit fee, which was the dependent variable. Data were collected using structured questionnaires distributed to 145 respondents, comprising audit professionals working in various Ethiopian audit firms. The data were subjected to statistical analysis using multiple linear regression, enabling the study to quantify the strength and direction of the relationship between each independent variable and audit fee pricing. The findings revealed that client risk, client complexity, auditor reputation, and market competition all have a statistically significant and positive influence on audit fees at the 1% significance level. This indicates that auditors tend to charge higher fees when clients are perceived as riskier or more complex. It also confirms that firms with stronger reputations can command higher fees, and that increased market competition does not necessarily lead to fee reductions. Instead, competition may push audit firms to enhance service quality and differentiation, which justifies higher pricing. On the other hand, client size, although positively associated with audit fees, had only a marginally significant effect, suggesting its influence on audit pricing is relatively weaker in the Ethiopian context. This implies that while larger clients may demand more audit effort, other factors like risk and complexity have a more pronounced role in determining the fee. In ensuring the robustness and reliability of the regression results, the study performed several diagnostic tests, including tests for multicollinearity, normality, and homoscedasticity. The results confirmed that the model did not violate the classical assumptions of linear regression, indicating that the findings are statistically valid and reliable for interpretation. In summary, the research confirms that audit fees in Ethiopia are influenced by measurable and rational determinants, consistent with audit pricing theories and international literature, but with notable local dynamics.

5.2 Conclusion

This study concludes that audit fee pricing in Ethiopian audit firms is not arbitrary, but rather driven by a set of identifiable client and market-related characteristics. Among the variables investigated, client risk

and client complexity emerged as the most significant determinants, reinforcing the role of audit planning, risk assessment, and the level of effort required in influencing fee decisions. These findings validate the notion that more complex and high-risk audits demand greater auditor expertise, time, and resources, which justifiably lead to higher fees.

The study also found that auditor reputation significantly affects fee levels. This highlights the premium clients are willing to pay for firms with an established record of reliability and quality, particularly in markets where audit credibility is critical. In such environments, the perceived quality associated with reputable auditors becomes a key driver of pricing.

Interestingly, market competition was also found to have a positive relationship with audit fees, a result that diverges from traditional expectations. This suggests a unique market behavior in Ethiopia, where increased competition may lead to higher quality service differentiation, specialization, or niche positioning rather than price-cutting. Such a finding reflects the complexity of competitive dynamics in professional service markets in emerging economies.

While client size did have a positive influence, its effect was less substantial, indicating that size alone is not a sufficient predictor of audit fees in the Ethiopian context. This suggests that other operational and risk-based factors weigh more heavily in auditors' pricing strategies.

Overall, the findings underscore the rationality and structure underpinning audit fee decisions in Ethiopia. They align well with global audit pricing literature while revealing distinct local market behaviors that warrant further examination.

5.3 Recommendations

In light of the study's findings, several recommendations are proposed for the key parties involved in audit fee determination and oversight.

For audit firms, it is important to continue integrating thorough risk evaluations and assessing client-specific complexities when setting fees. The pricing should accurately reflect the amount of work and risk involved in each engagement. Firms are also encouraged to invest in strengthening their professional image through consistent delivery of high-quality audits, hiring skilled staff, and upholding ethical practices. Building a trusted reputation allows audit firms to command justifiable premium fees. Furthermore, rather than reducing fees to remain competitive, firms should adopt differentiation strategies offering specialized services, focusing on particular industries, and maintaining audit quality to stand out in the market without compromising standards.

For regulators and policymakers, such as the Accounting and Auditing Board of Ethiopia (AABE), there is a need to issue clear and practical guidelines that take into account audit risk, client complexity, and market dynamics. These guidelines should help ensure that audit pricing is fair, transparent, and aligned with quality assurance goals. Regulatory bodies should also monitor market competition to discourage harmful price undercutting and instead promote a healthy competitive environment centered on quality. Additionally, regular assessment of audit fee practices and strong enforcement of professional standards are vital to safeguarding public interest and reinforcing confidence in financial disclosures.

For clients, it is essential to understand that audit fees are based on objective criteria such as the size, complexity, and risk associated with their operations. Clear communication with auditors about these influencing factors can enhance trust, reduce misunderstandings, and help clients better appreciate the value of a quality audit.

5.4 Recommendation for Future Studies

Considering the limitations of the current research, future studies are encouraged to broaden the scope by incorporating a wider range of variables that may influence audit fee determination. Factors such as the auditor's level of experience, the length of the audit engagement, firm ownership type, organizational size, regulatory influences, and complexities unique to specific industries should be explored for a more comprehensive understanding of pricing dynamics. Additionally, employing longitudinal or panel data in future research could help identify evolving patterns and the long-term impact of regulatory or economic changes on audit fee structures. Complementing quantitative methods with qualitative approaches, such as interviews or detailed case studies, can also provide deeper insight into the motivations behind certain pricing decisions, particularly the unexpected positive link between competition and higher fees. Moreover, conducting comparative studies with other developing countries could reveal whether the findings observed in Ethiopia are unique or reflect common trends across similar markets. Overall, such future research would contribute significantly to refining audit fee models and promoting equitable, transparent, and quality-driven audit practices.

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ANNEX – QUESTIONNAIRE

Dear Respondent,

I am conducting a study titled "**Determinants of Audit Fee Pricing: A Case Study in Ethiopian Audit Firms.**" Your participation in this research is highly valuable and will contribute significantly to generating well-informed and practical recommendations.

This questionnaire is designed to assess your professional opinion on various factors that influence audit fee pricing. It uses rating scales to measure your level of agreement with specific statements.

Please respond honestly based on your professional experience. Your answers will be kept strictly confidential and will be used solely for academic purposes.

Carefully read each statement and indicate your level of agreement by marking (X) in the box that best represents your opinion.

Your thoughtful and sincere feedback is greatly appreciated.

PART-I

General Information:

1. Your highest educational qualification:

☐ PhD ☐ ACCA/CPA ☐ Master's Degree ☐ Bachelor's Degree

2. Your current position in the Firm:

☐ Partner ☐ Audit Manager ☐ Senior Auditor

3. Years of experience in the audit profession (Respondent): _____ years

4. Number of audit clients served by the Firm per year (Approximate): _____ clients

5. Legal structure of the Audit firm:

☐ Sole Proprietorship ☐ Partnership ☐ Limited Liability Partnership

6. Number of years the Firm has been in operation:

☐ Less than 10 years ☐ 11–20 years ☐ More than 21 years

PART-II

Closed-Ended Questions

Instructions to respondents:

Please indicate your level of agreement using the scale below. Kindly mark your response with an (X).

Scale: 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree

Section 1: Client Size

1. Client size (in terms of total assets or revenue) significantly affects audit fee pricing.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

2. Larger clients generally require more audit effort, justifying higher fees.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

3. The number of employees at the client organization affects the audit fee.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

4. Clients with many daily transactions are usually charged higher audit fees.

- ☐ 1 Strongly Disagree
- ☐ 2 Disagree
- ☐ 3 Neutral
- ☐ 4 Agree
- ☐ 5 Strongly Agree

5. The size of the client's accounting/finance department influences the audit effort required.

- ☐ 1 Strongly Disagree
- ☐ 2 Disagree
- ☐ 3 Neutral
- ☐ 4 Agree
- ☐ 5 Strongly Agree

Section 2: Client Risk

1. Clients with higher financial risks (such as low liquidity or poor profitability) are associated with higher audit fees.

- ☐ 1 Strongly Disagree
- ☐ 2 Disagree
- ☐ 3 Neutral
- ☐ 4 Agree
- ☐ 5 Strongly Agree

2. Operational risks, including complex business operations and regulatory compliance issues, lead to increased audit effort and higher fees.

- ☐ 1 Strongly Disagree
- ☐ 2 Disagree
- ☐ 3 Neutral

- _____ 4 Agree
- _____ 5 Strongly Agree

3. The client's financial condition plays a significant role during audit fee negotiations.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

4. Frequent changes in key management positions at the client organization increase the audit risk and influence audit fee levels.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

5. Effective internal control systems can reduce audit procedures, thereby influencing audit fee levels.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

Section 3: Client Complexity

1. A client's business complexity (e.g., multi-branch operations, international presence, or complex structures) significantly increases audit fees.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

2. Diversified business activities or product lines require broader audit coverage, which raises the audit fee.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

3. A client's geographical dispersion (e.g., operations in multiple locations or countries) results in higher audit fees due to logistical and coordination demands.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

4. Clients using sophisticated accounting information systems (e.g., ERP systems) require more audit effort, thus affecting audit fee pricing.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral

- _____ 4 Agree
- _____ 5 Strongly Agree

5. The need for specialized technical expertise (e.g., industry-specific standards or systems) due to client complexity contributes to increased audit fees.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

Section 4: Auditor Reputation

1. Clients are more willing to pay higher audit fees to audit firms with strong local experience and a positive track record in the profession.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

2. An audit firm's adherence to professional ethics and reputation for integrity influences clients' willingness to pay higher fees.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

3. An audit firm's compliance with International Standards on Auditing (ISA) and local regulatory requirements justifies higher audit fees.

_____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

4. Clients consider the qualifications and professional certifications of audit engagement team members when evaluating audit fees.

_____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

5. Clients perceive audit firms affiliated with international networks as more credible and are willing to pay higher fees for their services.

_____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

Section 5: Market Competition

1. Clients' sensitivity to audit fees in a competitive market influences audit firms to offer lower pricing strategies.

_____ 1 Strongly Disagree
_____ 2 Disagree

- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

2. Despite the competition among audit firms, lower audit fees are often a result of client sensitivity to price rather than market dynamics.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

3. The lack of a regulated or standardized audit fee structure in Ethiopia contributes to significant variability in the fees charged by audit firms.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

4. Increased market competition in Ethiopia has a negative impact on the profitability of audit engagements.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

5. Clients in Ethiopia are often more concerned about audit fees than the quality of the audit service when selecting an audit firm.

_____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

6. Clients, particularly in the public sector, often prioritize price over audit quality, especially under tender-based selection.

_____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

7. The absence of strict enforcement by regulatory bodies results in inconsistent application of audit fee structures across audit firms.

_____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

8. Price undercutting (lowballing) is a common strategy among audit firms in Ethiopia to secure clients, despite potential impacts on audit quality.

_____ 1 Strongly Disagree
_____ 2 Disagree

- _____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

Section 6: Audit Fee Pricing

1. There is a significant variation in audit fees across clients in Ethiopia.

- _____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

2. Do you think that smaller audit firms tend to charge lower fees compared to larger audit firms in Ethiopia?

- _____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

3. Do you believe that audit fees are typically higher for clients with more complex business operations (e.g., multiple branches, international operations)?

- _____ 1 Strongly Disagree
_____ 2 Disagree
_____ 3 Neutral
_____ 4 Agree
_____ 5 Strongly Agree

4. Market competition has a large impact on audit fee differences.

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

5. Do you observe that audit firms charge significantly higher fees for clients that are perceived as being higher risk?

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree

6. In your opinion, does the absence of a regulated fee structure in Ethiopia contribute to the variability in audit fees?

- _____ 1 Strongly Disagree
- _____ 2 Disagree
- _____ 3 Neutral
- _____ 4 Agree
- _____ 5 Strongly Agree