



**ADDIS ABABA UNIVERSITY**  
**SCHOOL OF GRADUATE STUDIES**

Auditors' Professional Responsibility and Legal Liabilities With Regard To  
External Audit Firms in Ethiopia

By

MESFIN BIRHANU

PROJECT SUBMITTED TO THE DEPARTMENT OF ACCOUNTING AND  
FINANCE PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE  
AWARD OF MASTER OF ARTS (MSc DEGREE IN ACCOUNTING AND  
AUDITING

JUNE, 2024

ADDIS ABABA, ETHIOPIA

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LIABILITIES WITH REGARD TO EXTERNAL AUDIT FIRMS IN  
ETHIOPIA**

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**Advisor**

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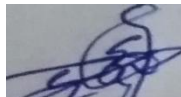
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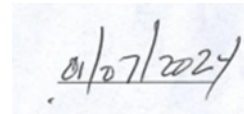
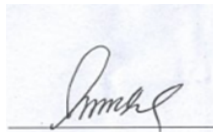
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## STATEMENT OF CERTIFICATION

This is to certify that Mesfin Birhanu has carried out his research work on the topic entitled “Auditors’ professional responsibility and legal liabilities with regard to external audit firms in Ethiopia” The work is original in nature and is suitable for submission for the reward of the Master’s Degree in Accounting And Auditing

Advisor: TAKELE FUFA (PhD)

Signature: \_\_\_\_\_  


Date 13 June, 2024

## STATEMENT DECLARATION

I, Mesfine Birhanu, declare that this work entitled “Auditors’ professional responsibility and legal liabilities with regard to external audit firms in Ethiopia” is outcome of my own effort and that all source materials used for the study have been duly acknowledged. It is submitted for the partial fulfillment of the masters of Arts Degree in Accounting and Auditing.

Name: Mesfine Birhanu

Signature:  \_\_\_\_\_

Date: June , 2024 \_\_\_\_\_

## ENDORSEMENT

This Project has been submitted to Addis Ababa University, School of graduate studies for examination with my approval as a University advisor.

Advisor: Takele Fufa (PhD)

Signature: \_\_\_\_\_  \_\_\_\_\_

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## ***Abstract***

*This Project examines the professional responsibility and legal liabilities of auditors within the context of external audit firms in Ethiopia. The study delves into the intricate Contractual agreement and explores the extent to which these professionals are held accountable for their actions. By analyzing relevant laws, regulations, and professional standards, the research highlights the expectations placed on auditors to uphold integrity, objectivity, and competence. Furthermore, the Project investigates the legal consequences auditors face when failing to meet these standards, Violating Contractual agreement. Through a combination of qualitative and quantitative methods, including case studies and interviews with industry experts, the research provides a comprehensive understanding of the current state of auditors' professional responsibility and legal liabilities in Ethiopia. The findings underscore the need for robust regulatory mechanisms and continuous professional development to enhance auditors' adherence to ethical standards and mitigate legal risks. This study contributes to the broader discourse on audit quality and accountability, offering valuable insights for policymakers, audit firms, and practitioners in the Ethiopian context.*

**Keywords: Professional Responsibility, Legal Liabilities, External Audit Firms, Accountability, Ethical Standards**

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# CHAPTER ONE

## Introduction

This chapter provided an overview of the theoretical background, statement of the problem, objective, research question, significance, and scope of the study.

### 1. Background of the study

Auditing, particularly external auditing plays a vital role in maintaining the integrity and transparency of financial information, which is crucial for the trust and confidence of stakeholders in any organization (Soltani, 2011). In the context of Ethiopia, the role of external audit firms has gained prominence due to the expanding complexity of business operations and regulatory requirements (OECD, 2019). This study seeks to explore the professional responsibilities and legal liabilities of auditors in external audit firms within Ethiopia, considering the practical implementation of performance audits, associated challenges, and future prospects.

Performance auditing goes beyond the traditional scope of financial audits by assessing the efficiency, effectiveness, and economy of an organization's operations (Knapp, 2011). In Ethiopia, the practical implementation of performance audits is still evolving. Auditors are tasked with not only verifying financial statements but also evaluating operational performance against predefined objectives (Institute of Internal Auditors, 2020). This multifaceted approach helps in identifying areas of improvement, ensuring optimal use of resources, and enhancing overall organizational performance. However, the effectiveness of these audits is often hindered by inadequate resources, limited access to relevant data, and insufficient training for auditors (Meigs & Meigs, 2012).

Despite the critical role of auditors, there are significant challenges that impede their professional responsibilities in Ethiopia. One major issue is regulatory ambiguities. The regulatory environment for auditing in Ethiopia is often seen as underdeveloped and inconsistently enforced, leading to ambiguities in the interpretation and application of auditing standards (RJ FCA, 2011). This inconsistency can significantly affect the quality and reliability of audits. Additionally, resource constraints present another formidable challenge.

Many audit firms in Ethiopia face limitations such as inadequate technological tools, lack of access to up-to-date information, and insufficient staffing, all of which can impede the thoroughness and accuracy of audits (Messier, Glover & Prawitt, 2018).

Another key challenge is the variation in the level of expertise and ongoing professional development among auditors. Limited training opportunities and a lack of exposure to international best practices can adversely impact the quality of audits conducted (Foulks, 2013). Moreover, auditors often face ethical and legal pressures that can compromise their objectivity and independence. Ethical dilemmas and potential conflicts of interest may arise, undermining the credibility of their work (Mrgis, 2012). These factors collectively hinder auditors from fulfilling their professional responsibilities effectively, highlighting the need for enhanced regulatory frameworks, better resource allocation, and continuous professional development (Knapp, 2011).

Despite these challenges, there are promising prospects for enhancing the role of auditors in Ethiopia. The government and regulatory bodies are increasingly recognizing the importance of robust auditing practices and are taking steps to strengthen the regulatory framework (OECD, 2019). Initiatives to enhance the professional education and continuous development of auditors are also underway, aiming to align local practices with international standards (Soltani, 2011). Additionally, the adoption of advanced auditing technologies and methodologies can further improve the efficiency and effectiveness of audits (Institute of Internal Auditors, 2020).

Several theoretical approaches underpin the study of auditors' professional responsibilities and legal liabilities. Agency Theory explores the relationship between principals (e.g., shareholders) and agents (e.g., auditors), highlighting the importance of auditors acting as independent agents to safeguard stakeholders' interests by ensuring accurate financial reporting and compliance with standards (Jensen & Meckling, 1976). Stakeholder Theory broadens the focus beyond shareholders to include other stakeholders such as employees, customers, and regulatory bodies, emphasizing the auditor's role in balancing various interests and ensuring fair representation in financial statements (Freeman, 1984).

Ethical Decision-Making Models, such as Kohlberg's stages of moral development and Rest's ethical decision-making framework, provide insights into how auditors navigate ethical

dilemmas and uphold their professional responsibilities (Kohlberg, 1981; Rest, 1986). Additionally, Institutional Theory examines how organizational practices and behaviors are influenced by institutional norms and regulations. In the Ethiopian context, this theory helps explain how local regulatory and cultural factors shape auditing practices and auditors' professional conduct (DiMaggio & Powell, 1983). By exploring these theoretical perspectives, the study aims to provide a comprehensive understanding of the professional responsibilities and legal liabilities of auditors in external audit firms in Ethiopia. This research will contribute to developing more robust auditing practices, enhancing the reliability of financial reporting, and protecting the interests of various stakeholders (Foulks, 2013; Knapp, 2011).

## **1.2 Statement of the problem**

The role of auditors in maintaining the integrity and transparency of financial information is paramount for the trust and confidence of stakeholders (Soltani, 2011). However, the practical implementation of auditors' professional responsibilities and legal liabilities presents significant challenges, both globally and locally (Messier, Glover, & Prawitt, 2018; Foulks, 2013). This study aims to explore these challenges within the context of Ethiopia, focusing on the performance of external audit firms.

Globally, numerous studies have highlighted key aspects of auditors' professional responsibilities and legal liabilities. For instance, research has shown that regulatory environments significantly impact the effectiveness of audits (Soltani, 2011). In developed countries, stringent regulatory frameworks and advanced technological tools enhance auditors' capabilities to maintain high standards of accuracy and reliability in financial reporting (Knapp, 2011). Studies also emphasize the importance of continuous professional development and adherence to ethical standards in safeguarding auditors' independence and objectivity (Messier, Glover, & Prawitt, 2018).

In the African context, however, the situation is markedly different. Studies have identified several impediments to effective auditing practices, including inadequate regulatory frameworks, limited resources, and insufficient training opportunities (Foulks, 2013). These challenges are exacerbated by ethical and legal pressures that compromise auditors' professional responsibilities. For example, in Nigeria, researchers have found that weak enforcement of auditing standards leads to inconsistent audit quality (RJ FCA, 2011). Similar findings have been reported in Kenya, where resource constraints hinder the thoroughness of audits (Institute of Internal Auditors, 2020).

While significant progress has been made in understanding the challenges faced by auditors globally and in some African countries, there remains a notable gap in the literature concerning the specific context of Ethiopia. There is limited empirical evidence on how Ethiopian external audit firms navigate the complexities of their regulatory environment, manage resource constraints, and address ethical dilemmas.

The motivation to embark on this research stems from the urgent need to address these gaps in the literature. By focusing on the Ethiopian context, this study aims to provide a comprehensive understanding of the practical implementation of auditors' professional responsibilities and legal liabilities. It seeks to uncover how regulatory ambiguities, resource constraints, and variations in professional expertise affect the quality and reliability of audits in Ethiopia. Furthermore, this research will explore the ethical and legal pressures that auditors face and how these challenges can be mitigated to enhance audit quality.

It will provide insights that can inform policymakers and regulatory bodies on the necessary steps to strengthen the regulatory framework and support continuous professional development for auditors. Additionally, the findings will offer valuable guidance for audit firms on adopting advanced auditing technologies and methodologies to improve their efficiency and effectiveness.

This research is particularly timely and relevant given the increasing complexity of business operations and regulatory requirements in Ethiopia. As the country continues to develop its economic infrastructure, the demand for high-quality audits will only grow. Therefore, understanding and addressing the challenges faced by auditors is crucial for ensuring the integrity and transparency of financial information, which is essential for fostering trust and confidence among stakeholders and promoting sustainable economic development.

## **1.3 Objective**

### **1.3.1. The general objective**

- This study aims to examine the professional obligations and legal accountability of external auditors operating in Ethiopia, specifically focusing on the auditor's role, responsibilities, and responsibility.

### **1.3.2. Specific Objective**

In light with the above general objective, the following points are set as the specific objectives.

1. To assess the extent to which external auditors fulfill their professional and legal obligations when performing audit tasks.
2. To examine the client's purpose in the process of creating financial statements.
3. To assess the potential legal liability faced by external auditors in relation to their engagement in illicit audit activities.
4. To evaluate the limitations faced by external auditors when endeavoring to fulfill their duties

#### **1.4. Research Questions**

These are research questions of the research:

1. To what extent do external auditors fulfill their professional and legal obligations during the execution of audit tasks?
2. What is the significance of the client's role in the formulation of financial statements, and how does it influence the audit process?
3. What are the potential legal liabilities that external auditors may encounter concerning their involvement in illicit audit activities?
4. What are the limitations faced by external auditors in the course of discharging their duties, and how do these constraints impact the effectiveness of their audits?
5. How can a connection between auditors' liability and their clients be established, and what are the primary legal principles governing this relationship?

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

The study's results and conclusions provided valuable insights for relevant stakeholders within the country, enabling them to gain awareness of prevailing practices and effectively address the issue of non-compliance with professional and legal obligations. This study aims to enhance the understanding and recognition of auditors' professional obligations and legal accountability among many stakeholders, including educators, students, shareholders, and other relevant entities. Additionally, this research seeks to make a valuable contribution to the current body of literature on this topic. Furthermore, this study is of value to academics and researchers who seek to utilize the findings as a foundation for ongoing and future investigations pertaining to the topic.

## **1.7. Scope of the Study**

This research focused on exploring the professional responsibilities and legal liabilities of auditors in the context of external audit firms within the Ethiopian business landscape. The study encompasses the following key components:

The study specifically investigated external audit firms operating within Addis Ababa, Ethiopia. It considered diverse geographic locations within the city to capture variations in business practices and regulatory environments.

The primary participants in this study included external auditors working in Ethiopian audit firms, professionals in the field of accounting and auditing, and relevant regulatory bodies overseeing auditing practices in Ethiopia. The research covered a specified time frame, focusing on recent developments in auditing practices in Ethiopia. Historical data may be considered to provide context, but the emphasis was on contemporary issues.

## **1.8. Organization of the Study**

This proposal is structured into five chapters, each containing distinct subsections as follows: Chapter One serves as the introduction, providing the study's background along with an overview of the organization involved. It includes definitions of key terms, a statement of the problem, research questions and objectives, the significance of the study, the scope of the research, and the organization of the paper. Chapter Two delves into relevant literature, offering a comprehensive review of existing scholarly works and studies related to the subject matter. Chapter Three encompasses the methodology section, covering research design, research population, sampling techniques, data collection instruments, and data analysis procedures. Chapter Four involves discussion and analysis, while Chapter Five presents conclusions and recommendations.

## **CHAPTER TWO**

### **REVIEW OF RELATED LITRATURE**

#### **2. Introduction**

This chapter provides a concise explanation of audit standards, responsibility, and legal liability as they pertain to research studies.

#### **2.1 Theoretical literature**

##### **2.1.1 Agency Theory**

Agency theory explores the relationships between principals (shareholders) and agents (auditors) in organizations. In the context of this research, it can provide insights into how auditors act as agents responsible for safeguarding the interests of shareholders and the broader public by fulfilling their professional responsibilities and understanding the legal liabilities tied to their roles (Jensen & Meckling, 2011).

##### **2.1.2 Stakeholder Theory:**

Stakeholder theory considers the interests of various stakeholders beyond just shareholders. In the context of auditing, this theory can be applied to understand how auditors balance the expectations and responsibilities towards clients, regulatory bodies, and the public, especially in the Ethiopian business environment (Freeman, 2005).

##### **2.1.3 Professional Skepticism:**

Professional skepticism is a fundamental concept in auditing, emphasizing the need for auditors to approach their work with a questioning mindset. This theory can be explored to understand how auditors exercise professional skepticism in fulfilling their responsibilities, particularly in the face of potential legal liabilities in Ethiopian external audit firms (Hurt, 2010).

##### **2.1.4 Legal Liability Theory**

This theory focuses on the legal responsibilities and liabilities associated with professional roles. In the context of auditing in Ethiopia, this theory can help delineate the legal framework governing auditors, examining how legal principles are established and how auditors navigate potential liabilities (Arens et al., 2016).

##### **2.1.5 Audit Quality Frameworks:**

Various frameworks, such as the International Standards on Auditing (ISA), can be explored to understand the guidelines and benchmarks set for audit quality. The research can

investigate how auditors in Ethiopian external audit firms align with these frameworks in their pursuit of professional responsibility and legal compliance (IFAC, 2020).

### **2.1.6 Institutional Theory**

Institutional theory can shed light on how auditors conform to or challenge institutional norms and expectations. In the Ethiopian context, this theory can be applied to explore the influence of local institutional factors on auditors' professional responsibilities and legal liabilities (DiMaggio & Powell, 1983).

### **2.1.7 Ethical Decision-Making Models:**

Ethical decision-making models, such as the Kohlberg model or the Rest model, can be employed to understand how auditors navigate ethical dilemmas associated with their professional responsibilities and legal obligations in the Ethiopian external audit setting (Rest, 1986).

### **2.1.8 Regulatory Capture Theory**

Regulatory capture theory explores how regulatory bodies may be influenced or captured by the industries they regulate. In the Ethiopian context, this theory can be applied to investigate the dynamics between auditors, external audit firms, and the regulatory framework, impacting professional responsibility and legal liabilities (Stigler, 1971). By integrating these theoretical perspectives into the literature review, the research can establish a comprehensive foundation for understanding auditors' professional responsibilities and legal liabilities in Ethiopian external audit firms.

### **2.1.9 Credibility Theory in Auditing**

Credibility theory, often associated with actuarial science and insurance, is increasingly relevant in the field of auditing. This theory focuses on the trustworthiness and reliability of information provided by various sources. In the context of auditing, credibility theory suggests that auditors must establish the reliability of financial statements to instill confidence among stakeholders.

### **2.1.10 Application in Auditing**

Auditors, as external verifiers, play a critical role in enhancing the credibility of financial reports. According to Kinney and Libby (2002), the auditor's credibility is a function of their independence, objectivity, and expertise. When auditors are perceived as credible, their attestations add value to the financial statements, thereby increasing stakeholders' trust.

### **2.1.11 Factors Influencing Credibility**

Several factors influence the credibility of auditors, including their professional qualifications, adherence to ethical standards, and the rigor of their audit processes. Bedard

and Johnstone (2004) argue that auditor credibility is also affected by the quality of the audit firm's internal controls and the thoroughness of its quality assurance programs. Additionally, the transparency of audit procedures and the clear communication of findings further bolster the auditor's credibility (DeFond & Zhang, 2014).

### **2.1.12 Rational Expectations Theory in Auditing**

Rational Expectations Theory (RET), originally developed in the field of economics, posits that individuals form expectations about the future based on all available information and their understanding of the economic model. In auditing, RET implies that stakeholders form expectations about the accuracy and reliability of financial statements based on their knowledge of the audit process and the auditor's reputation.

### **2.1.13 Implications for Auditing**

According to Brown and Tarca (2005), rational expectations theory can be applied to understand how stakeholders perceive the reliability of financial reports. If stakeholders believe that auditors conduct thorough and unbiased audits, they are more likely to have confidence in the reported financial information. However, if past audits have revealed significant misstatements or if auditors have been involved in scandals, stakeholders may adjust their expectations downward.

### **2.1.14 Enhancing Stakeholder Confidence**

To align with rational expectations, auditors must ensure that their practices are transparent and that they communicate the limitations and scope of their audits clearly. This transparency helps in setting realistic expectations among stakeholders (Francis, 2011). Additionally, continuous professional education and adherence to evolving standards can help auditors maintain their credibility and meet the rational expectations of stakeholders.

## **2.2 Evolution of Auditing**

The origins of auditing can be traced back to ancient Mesopotamia around 3500 BC, where there is evidence of early civilizations recognizing the importance of protecting state and personal property through record-keeping. The financial transaction records exhibited various markings that could be interpreted as a system for verification, internal controls, and separation of duties. In Ancient Rome, a practice known as the "hearing of accounts" was employed, wherein an official would compare his records with those of another (Gansberg et al., 2003). This involves the implementation of both separation of duties and verification practices, specifically the process of examining financial records, which led to the term "audit" derived from the Latin word "audire," meaning to listen. During the medieval period,

the Industrial Revolution in Europe brought about significant changes to the field of auditing. This transformation expanded the scope of auditing from solely examining financial accounts to encompassing the verification of accounting records and their accompanying supporting documentation. Since World War II, internal audit has undergone significant development, expanding its focus from primarily financial and accounting matters to encompassing a broader scope of operational activities. The growth and decentralization of organizations, along with the increased complexity of their operations, have driven the advancement of the internal audit profession. This is due to the need for effective monitoring of the numerous activities within these organizations. Government organizations are typically required to have an internal auditing function and an audit committee consisting of non-management directors (Gliem, 2000).

### **2.3 Demand and supply of audit**

Diverse dynamics of demand and supply give rise to financial statements. The auditor plays a crucial position in this system, first as a provider of audited financial statements and second as a monetary agent assuring those who seek corporate financial reports of the accuracy of that information. Assessing the need for regulation and ensuring the smooth operation of the audit market can be aided by taking a theoretical approach to the demand and supply of audit. The notion of demand for auditing and the incentives this demand produces for the supply of audits are crucial to elucidating the function and responsibilities of external auditors in the capital market (William H. Beaver, 1989), hence this debate is necessary. Current regulations place limitations on auditors and impose penalties on them if they fail to conduct quality audits. Recent worries over auditors' place in financial markets highlight the need for a clear explanation of auditing's demand, which should begin with the observation that auditing is sought after because it helps eliminate knowledge asymmetry between contractual parties. To fully understand the information supply and demand process, the following diagram is required viewing.

### **2.4 Concepts of Auditing**

According to the policeman theory, an auditor's job is to look for, find, and stop fraud. However, audits now primarily serve to provide reasonable assurance by confirming the accuracy and fairness of financial accounts. The role and function of auditing are poorly explained by the policeman theory (Gliem, 2000). If you believe the lending credibility argument, the audit's main purpose is to provide investors' confidence in the financial

accounts. Financial statement users' confidence in the financial data and trust in management are both bolstered by audited financial statements. This theory's explanatory value is restricted since it only accounts for one function of conducting audit services-lending credibility-(Gansberghe, 2003). There are two main ways in which audit services are distinguished from other types of professional services, as described by Zerni (2009). While the client hires and pays the auditor, the product is ultimately used by investors and other third parties to whom the auditor owes a duty of care. Second, it is impossible to know for sure how good an audit will be before signing a contract, and often not even afterward. The issued audit report is the only tangible result of an audit, yet it provides very little insight on the quality of the audit in its default form. According to Watkins et al. (2004), an integral part of an auditor's professional behavior is to collect and evaluate all relevant evidence prior to writing the audit report. Without supporting evidence, an auditor cannot assert that a certain region has been tested. According to Brown (1999), an audit can be broken down into a series of tests and a process of acquiring evidence. The evidence acquired in the form of documentation is crucial for defending any potential challenge from an authority or defending her or his professional appearance by showing that she or he was following routines that make sense and have worth in the audit society.

In his article "The General Concept of Auditing in Ethiopia" for the Emerald Journal, Gilo (2010) provides a definition of external auditors in the Ethiopian setting. A certified public accountant (CPA) or external auditor is one who is not affiliated with the company being audited. The audit is performed by an independent auditor for a fee, who is primarily accountable to the company's external stakeholders (such as its creditors and shareholders). An audit of financial statements is what an independent auditor does. In Ethiopia, only certified public accountants are allowed to audit annual reports. The government-owned Audit Service Corporation also conducts audits of financial statements.

Since of this, auditors have been given the responsibility of conducting statutory audits, and their work is crucial to the smooth operation of businesses since it increases confidence in the data. This confidence has been placed in the auditor on the basis of the social roles of an auditor, which include examining the management's behavior and the economic information provided by the company in an effort to reduce contractual conflict leading to the so-called agency cost between the board of directors of the company, who controlled the preparation of accounts, and external owners (Carson and Dowling 2005; Watkins et al. 2004; Chow 1982). The quality of the company's management and operations can be confirmed by conducting an

audit. Therefore, an auditor must ensure quality for both internal and external customers. A wider scope and additional evidence that the audit is undertaken for more users than external owners is provided by the notion that the audit has the job of assuring quality for external users (Carson and Dowling, 2005).

## **2.5 Auditors Rule of Professional Conduct**

Integrity, objectivity, competence, application of professional abilities, and consideration for others are cornerstones of professional conduct. To wit: (Foulks lynch, 2004). Every member's professional, business, and personal financial dealings should be conducted with the utmost honesty. Being objective is thinking just about what is necessary for completing the task at hand. Auditors shouldn't take on tasks for which they lack the knowledge or experience unless they have access to the resources necessary to complete them effectively. Professionals are expected to perform their duties with competence, care, diligence, and good manners (Foulks, 2004). As stated by Foulks (2004), the rules of professional conduct serve as the ethical foundation of auditing.

### **2.5.1 Integrity and objectivity**

Integrity is not just about being truthful, but also about being fair and trustworthy. An external auditor needs to be impartial and not let influences from others, conflicts of interest, or personal bias cloud their judgment. In their varied roles, independent auditors must always maintain their impartiality. As a trusted economic actor, the auditor has a responsibility to ensure the accuracy and reliability of financial statements and other accounting data (Auditing Practices Board (UK), Ethical Standard 1, 2004). However, objectivity is a mentality that is free from bias, prejudice, and compromise and that gives due weight to everything that is pertinent to the work at hand while excluding everything else. In order to maintain objectivity, the auditor must be free of biases (Soltani, 2007).

### **2.5.2 Professional competence and due care**

Auditors need to be easily recognized as accounting experts by government agencies, businesses, and the public at large. To ensure that their clients benefit from competent professional service in light of the latest developments in practice, legislation, and techniques, external auditors have a continuing obligation to maintain professional knowledge and skill in order to carry out attestation and other professional services with due care, competence, and diligence. It is important for external auditors to be honest about their level of competence and experience (Foulks, 2004).

### **2.5.3 Prohibited ethical conflicts in external auditing**

Although conflicts of interest may not always compromise an auditor's objectivity and independence, they are generally forbidden to prevent any appearance of bias. This strictness, in the eyes of some observers, is really an act of pretense at autonomy.

Since there are no hidden conflicts of interest, public perception is all that can be relied upon. Some examples of laws based on the perceived rather than the proved hazards of conflicts of interest are prohibitions on audit partners having stock in the clients they audit and rigorous eligibility restrictions on corporate directors serving on audit committees. (Bill Beaver, 1989).

### **2.5.4 Confidentiality**

An external auditor usually has access to highly confidential information, not otherwise disclosed to the public, about the client's affairs. Users of the services of external auditors should be able to feel confident that there is a framework of professional ethics governing the provision of these services. This requires that auditors respect the confidentiality of information acquired during the course of performing the audit and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose. This does not apply to disclosure to properly discharge the independent auditor's responsibility in accordance with the profession's standards (Carson and Dowling 2005).

### **2.5.5 Professional behavior**

Quality assurance services should be provided by certified public accountants. An external auditor should maintain the integrity of the auditing profession and avoid doing anything to damage that reputation. The duties of an external auditor toward audit clients, investors, third parties, and other members of the audit profession, as well as toward staff, employers, and the general public, must be taken into account by audit firms and/or professional bodies when formulating ethical requirements (Carson and Dowling 2005; Watkins et al. 2004; Chow 1982).

## **2.6 Basic requirements for compliance with ethical standards**

Auditing financial statements is governed by a set of internationally accepted ethical and professional norms in most countries with mature capital markets. These norms are typically issued by international bodies such as IFAC. The audit firm, its partners, and its professional

employees are responsible for ensuring that they adhere to these standards of honesty, objectivity, and independence.

To guarantee that the audit company and all individuals who can affect the conduct and outcome of the audit adhere to the core ethical standards, the audit firm should develop policies and processes, which should be well recorded and disseminated. Auditors should not be biased in their work because of financial ties to the client or other personal connections. For instance, it is acknowledged that financial reliance on a single customer or small group of clients can cloud judgment. Therefore, a company that relies heavily on a single client may be reluctant to take a stance on an issue because doing so could result in a catastrophic loss of revenue (Foulks lynch, 2004). Any request for an auditor to turn over their working papers must be denied on the grounds that they are confidential. If the tax authority asks working papers related to a specific customer whose affairs are being investigated, however, auditors should respond in a way that is optimal for the client. To wit: (Foulks lynch, 2004). According to Arens and Loebbecke, the AICPA code of professional conduct consists of either broad, aspirational declarations or narrowly tailored guidelines outlining what is and is not acceptable in the accounting profession. Since 1991 (Arens & Loebbecke). Accordingly, the code is broken down into four sections—principles, standards of conduct, interpretations, and ethical rulings—with increasing levels of detail. Since 1991 (Arens & Loebbecke).

Ethical principles are philosophically defined but unenforceable ideals of right and wrong behavior. Member should perform all professional responsibilities with the highest sense of integrity; Member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities; Member should accept the obligation to act in a way that will serve the public interest; honor the public trust; and demonstrate a commitment to professionalism. The rules of conduct are a set of enforceable minimum requirements for appropriate behavior. Listed here are the hard and fast guidelines that every certified public accountant must observe. These sections are not enforceable because they require written interpretations of the standards of conduct in response to frequent enquiries from practitioners regarding a particular rule. These detailed ethical judgments are the answers to inquiries about the AICPA's code of ethics provided by the organization's executive committee. Since 1991 (Arens & Loebbecke). Fundamental principles, including members' responsibilities to the public and the profession; integrity, due care, and competence; objectivity; and responsibilities to clients and colleagues are all highlighted in the rules of professional conduct of various provincial institutes, as noted by Meigs, Whittington, Pany, Megis, and

Lam, Meigs, Whittington, Pany, Megis, and Lam (1992) outline the applicable and enforceable rules of behavior and interpretations of norms of professional conduct.

From the explanations provided by various authors, it is possible to deduce that the norms of professional behavior adopted by public accountants across most countries are consistent with one another in general but vary in their detail and are enforceable by the profession.

## **2.7 Auditor's Professional Responsibilities**

The United States Government Accountability Office (U.S.GAO) made known online that the audited organization, and not the auditor, is responsible for preparing financial reports. Thus, auditors of government programs or entities, as well as officials of the audited entity entrusted with handling public and private resources, play crucial roles and responsibilities in ensuring that public resources are used economically, effectively, and legally. The ability of auditors to carry out their duties is also a key obligation for auditing organizations. These specialized functions require the application of best-in-class auditing, attestation, and management methods. (U.S. GAO reports found online) The audited entity's management is responsible for (for example, managers of a state or local government organization or managers of a nonprofit receiving federal payment).

It is important to define the goals and parameters of the auditor attestation engagement. In addition to cost, the responsiveness of the bidder to the request for a proposal, the bidder's past performance and experience, the availability of the bidder's staff with the necessary professional qualifications and technical abilities, and the results of the bidder's peer reviews may all be taken into account when evaluating bid proposals (Internet source: U.S. GAO). U.S. Government Accountability Office explains the auditor's duties as follows: Auditors have a duty to act in accordance with the standards for which the program was designed or for which resources were allocated.

observing all relevant legal obligations, such as determining which rules and regulations an organization or individual must follow and putting in place procedures to ensure compliance; putting in place and maintaining a system of internal controls that helps guarantee that desired outcomes are achieved, that resources are used effectively, economically, and safely, that statutory and regulatory requirements are met, and that accurate information is obtained, stored, and disclosed in a transparent manner. Keeping watchdogs and the public up-to-date with the proper reports they need to hold government agencies responsible for their spending and the outcomes of their initiatives; Taking action in response to audit findings and

recommendations and setting up a system to monitor their progression; Contracting for audits and attestation activities in accordance with best procurement standards, including setting up mechanisms to track progress.

According to the United States Government Accountability Office (GAO) (online). U.S. Government Accountability Office explains the auditor's duties as follows: An auditor's professional duties include acting with the utmost honesty, objectivity, and independence while also serving the public interest. The auditors' duty is to act in the public interest, which is the benefit of the persons and organizations they examine. Professionalism, integrity, and serving the public interest are all qualities that should guide an auditor's actions. The willingness to take on public duty is a defining feature of any respected profession. When conducting audits for the government, this duty is of the utmost importance. In order to best serve the public interest, GAAS reflects the principle of accountability. When making judgments, auditors must keep the public interest in the audited program or activity in mind.

Professional auditors may face competing interests from the audited organization's management, different tiers of government, and others who depend on the auditors' independence and objectivity. When settling such disagreements, auditors must do so in an ethical manner, based on the principle that the public's interest is best served when auditors do their jobs. Auditors need to act with the utmost integrity in carrying out their professional duties if they want to continue to enjoy widespread public trust.

Relationally with audited entities and readers of audit reports, auditors must be professional, objective, fact-based, impartial, and non-ideological. Within the bounds of the audited entity's confidentiality laws, regulations, or policies, auditors should be open and forthright with the audited entity and users of the auditors' work. Auditors must use restraint in their application of knowledge gained in the course of their work. They must not utilize it for their own benefit or in a way that undermines the audited entity's legitimate and ethical goals. Gaining at the expense of others' service and trust is unacceptable. Having integrity means being able to admit to making a mistake or having a legitimate disagreement without compromising your values. For auditors to maintain their credibility, they must adhere to the letter and the spirit of applicable technical and ethical standards. Auditors must maintain their objectivity and independence in order to ensure integrity. It is unacceptable for an auditor to put their own interests ahead of those of the public or their own firm when performing auditing duties.

To be objective, auditors need to avoid bias, have strong critical thinking skills, and not have any personal stakes in the outcome of their audits. Auditors must be free from any relationships that could compromise their impartiality during an audit or attestation assignment. Professional judgment is required by auditors in the application of GAAS, including in the selection of work to be conducted, the design of audit procedures, the execution of audit procedures, and the communication of audit results. To make conclusions that are in line with the larger public interest in the program or activity under examination, auditors must maintain integrity and objectivity at all times.

To prevent misleading knowledgeable users, misrepresenting the results, or covering up inappropriate or illegal actions, auditors must disclose all important or significant information known to them while reporting on the results of their work. Auditors must ensure that management and other users of the reports have a firm grasp of the auditor's responsibilities in accordance with GAAS and any additional attestation coverage mandated by law or regulation. During the planning stages of an auditor attestation engagement, auditors must communicate information concerning the planning, conduct, and reporting of the engagement to the parties involved in order to help managers and other report users understand the objectives, time frames, and data needs of the engagement. U.S. Government Accountability Office On the other hand, audit organizations (auditors) are accountable for ensuring that (1) independence and objectivity are maintained throughout the assignment, (2) professional judgment is used in planning and performing the work and reporting the results, (3) the work is performed by personnel who are professionally competent and collectively have the necessary skills and knowledge, and (4) an independent party performs the audit. While it is the responsibility of management to act on audit and attestation engagement findings and recommendations and monitor their progress toward resolution, it is the responsibility of audit organizations to put in place policies and procedures for following up to see if the findings and recommendations from prior engagements are taken into account when planning future engagements. (U.S. GAO reports found online)

Furthermore, RJ Anderson emphasized that auditors' responsibilities are based on locally enforced standards of professional conduct. However, most of these regulations make reference to professional accounting and auditing standards, which are heavily affected by the suggestions in national standards. GAAS is the most fundamental auditing advice. (R.J.Anderson FCA, 1984)

Generally Accepted Auditing Standards are the gold standard for evaluating an organization's effectiveness. According to Arens and Loebbecke, GAAS also shows that auditors care greatly about ensuring that all public accountants do audits of the same high quality. Auditors' comments on financial statements will be given more weight by the public if public accountants all have the necessary technical training and conduct audits with the utmost skill, care, and professional judgment. Since 1991 (Arens & Loebbecke). The professional obligations of auditors are grounded in three overarching standards (Arens and Loebbecke, 1991, No. 1): United States Generally Accepted Auditing Standards (GAAS) and the AICPA's Statements on Auditing Standards No. 1 (SAS-1) from 1972.

## **2.8 Auditors Legal Responsibilities**

Some authors argue that the legal responsibility of an auditor depends on whether or not an audit is required by law (either federally or locally) and classify this as a statutory, contractual, or both statutory responsibility. The auditor's and the client's shared decision on the terms of the contract establishes legal liability. The two parties may also mutually agree to perform services beyond what is required by law; in this case, the auditor will be held accountable to the client for meeting both the legal and contractual obligations. The auditors should also be well-versed in the relevant legislation for each of their clients (Megs, Whittington, Meigs, and Lam, 1987). Financial statement auditors are required by law to express an opinion on whether or not the financial statements give a "true and fair view" or "present fairly the financial position and results of its operations," and to communicate this opinion to the company's users. Specific responsibilities were also deemed stippled in statutory requirements, such as determining whether or not the information in the management report is consistent with the financial statements and whether or not the company has kept sufficient accounting records. as reported by (Foulks Lynch, 2004). According to RJ Anderson (RJ Anderson FCA, 1984), an external auditor's duties can be traced back to common law principles in three different areas: legislation, as construed by common law; contracts; and torts. The auditor is held liable for both the terms of the engagement letter between the auditor and the client and the requirements of any applicable laws requiring an audit.

## **2.9 Auditors Legal Liability**

Lawyers, analysts, accountants, and auditors have traditionally placed a higher level of duty and care on their shoulders than those in other service industries. This means they are held accountable to a higher standard than the average businessperson for the results of their

professional advice and commercial endeavors. It has always been expected of professionals that they fulfill their duties with due diligence. Particularities in the nature of the professional's relationship with his or her client, as well as the significance of the client's reliance on the professional's services, have contributed significantly to these outcomes. In a company climate that is always shifting due to technology advancements, the concerns of legal liability and its ramifications for the audit profession are of paramount importance and essential importance. Similar to many other fields, auditors have been preoccupied with the question of who is legally responsible in the event of malpractice. There is always the possibility that auditors will miss a major falsification of financial data in the course of completing their duties. Auditors have a duty of care to their clients and are held legally liable for their actions in the workplace. This duty can be established either by common law or by statute. However, in recent years, the liability structure under which practitioners in high-risk industries like auditing operate has become increasingly costly and onerous. This is largely attributable to the fact that auditors operate in a dynamic legal environment that is always changing as a result of shifts in the expectations and perceptions of information users.

## **2.10 Types of audit professional liability**

There are three tiers to a professional's liability (Canadian Bar Association, 1996: 8): the personal liability of the partner who committed or oversaw the conduct or omission at issue; Liability of one defendant extends to the assets of all defendants, regardless of whether or not the defendants were partners in the liable business. It is important to explain the terminologies in this area, including "limited liability," "joint and several liabilities," "proportionate liability," and "statutory capping," before analyzing auditor liability and clarifying the arguments for and against limited liability for auditors.

The current legal climate makes auditors, lawyers, and company directors all too appealing targets for investors and creditors who suffer financial setbacks and sue for professional negligence. Every audit should be treated as if the auditor will have to defend their findings in court. It can be exceedingly expensive to defend a legal case, even if the court rules in the auditors' favor. Professional liability insurance premiums have consequently skyrocketed. Meigs, Whittington, Meigs, and Lam (1987). Therefore, financial implications aren't the only thing to think about; a professional's reputation is also at risk. The auditors could face criminal charges if the situation warrants it. As a result, auditors face legal responsibility to both their clients and any third parties who place reliance on audited financial statements.

According to Foulks lynch (2004), legal obligations carry financial risks in case of mishaps. In nations with civil code legal traditions, auditor liability falls within the category of liability under laws, either civil or criminal, while in countries with common law legal traditions, liability of auditors arises from carelessness. Directors and others in charge of a corporation are held liable for fines under the civil code in many countries, and in those with civil code legal traditions, liability originating from carelessness under common law is also recognized.

Accepting an appointment as auditor when one is not qualified to do so, or staying in office after becoming ineligible, is a serious violation. Falsifying accounting records or papers or publishing a misleading statement with the intent to defraud members or creditors may be criminal offenses. The corporation can sue the auditor for breach of contract if the auditor fails to deliver an audit report or presents a carelessly drafted audit report, as stated by (Foulks lynch). According to the general principle of owing a duty of care to those parties and being liable in the tort of negligence if he fails in that duty, auditors in countries with common law legal traditions may be liable to shareholders and others who have relied on the financial statement upon which he expressed an opinion.

Damages awarded by a court are a liability in the castle because they represent money that could have been paid to a non-contractual party who successfully sued the auditor. It has been noted in the literature (Meigs Whittington, Meigs, and Lam, 1987) that auditors can be held responsible for damages if they do not use reasonable care in their audits of their customers' financial records. This duty exists regardless of whether or not it is stated in the formal agreement with the customer. Accordingly, under common law, private auditors are responsible to their customers for any damages that are proximately caused by the auditor's failure to exercise due professional care. A damaged client need only show that the auditors were negligent and that the auditors' carelessness was the proximate cause of the client's losses in order to collect damages from them. Common law has evolved to address the issue of private auditing firms' obligation to outside parties. Several landmark decisions have shaped the auditor's duty to anyone who may place their trust in the auditor's report. In such lawsuits, the auditors face third-party claims of negligence, gross negligence, or fraud. For an audit to be considered negligent, it must not have been conducted in conformity with generally accepted auditing principles. A finding of gross negligence could be made if an auditor significantly deviates from generally accepted auditing norms. According to the definition provided by Meigs, Whittington, Meigs, and Lam (1987), fraud occurs when one party intentionally misrepresents a material fact with the intent to deceive another party and

causes that party to suffer damages as a result. Private auditors incur legal liability to third parties if they fail to fulfill their statutory, contractual, and tort obligations, as stated in RJ Anderson (RJ Anderson FCA 1984). Most mistakes that could subject a private auditor to legal action are covered by the tort law, and more specifically the tort of negligent misrepresentation.

Negligence occurs when a person either fails to fulfill a legal obligation or fails to do so with the level of care that the law requires. The technical character of the lawsuit taken against the auditor may be affected by whether the duty is statutory, contractual, or one in tort. Tort law governs actions filed by third parties against auditors for negligence, while breach of contract law governs actions made by auditors against their clients (RJ Anderson FCA: 1984). Several authors have suggested that litigation has already had and will continue to have a major effect on the practice of public accounting.

Legal action can be avoided if the auditor follows all professional pronouncements and exercises good judgment throughout the audit and before issuing the report. There is still a lot of confusion about who is responsible for damages caused by an audit. If an auditor breaches their obligation to their client, they can be held accountable for damages under corporate law. However, cases in court have been crucial to the development of legal interpretation. Gill, Cosserrat, Leung, and Coram (1999) Grant Gay and Roger Simnett state that the auditor owes the client a duty of care under both the contract and the tort of negligence. If the auditor has been careless, the clients might claim for breach of contract to get their money back if anything bad happens. Alternatively, the customer might sue the auditor for negligence and seek damages equal to the difference between where they were and where they should be. Furthermore, many cases have been filed over the auditor's liability in regards to parties apart from the direct client. 27 Private auditors in Ethiopia: their legal responsibilities and ethical obligations No contractual right to recover losses exists for third parties who depend on an auditor's assessment and suffer a loss due to the auditor's negligence.

However, a tort action, which is brought by a third person who has been harmed, is a civil wrong for which damages are awarded. If a legally protected interest has been jeopardized, then a tort case may be pursued (Grant Gay & Roger Simnett). In light of the preceding talks, the researcher concludes that the auditor in question should face legal consequences for the aforementioned breaches of contract, statute, and/or both.

As a result, an auditor should be held responsible before the client for breaking both the contract and the law when conducting an audit. In addition, the auditor should be accountable in tort to any third party who incurs damages as a result of an untimely audit report.

## **2.10 Legal Liability of Auditors**

Each day brings new worries about the auditor community's exposure to legal risk. Auditors play a crucial role in society since their work improves the trustworthiness of financial statements used by everyone. They are subject to the same risks of civil and criminal culpability as any other professional when carrying out their work. Many incidents of fraud around the world would not have been uncovered if not for independent and qualified auditors. In fact, auditors are obligated by their code of ethics to do their duties with the utmost care. The "prudent person" idea refers to the necessity of exercising due care.

### **2.1.10 Sources of Legal Liability for an Auditor**

Let us consider the possible entities that may sue an auditor and the possible reason for a lawsuit.

#### **2.1.10.2 The Legal Liability of Auditors to Third Parties**

This article raises the issue, "Who exactly are auditors responsible for?" Is it possible for a client to sue an auditor? Maybe there's a certain group of people involved. Auditors are held accountable by two distinct sets of third parties: (1) those who are already familiar with and rely on the financial statements, and (2) those who may one day become such users. Actual shareholders and creditors are the only users of the financial statements who are public knowledge. The company often has a comprehensive, name-based roster of all such people. The second category, potential users, calls for some discretion. Foreseeable customers might include, for instance, possible investors and the potential creditor (i.e., a bank) if the company is seeking to raise capital through the issuance of fresh equity or a loan from the bank. The auditor understands the type of user, even if they do not know the exact user, because the client will use the financial statements to raise bank funding or issue fresh shares.

#### **2.1.10.3 Unjustified Lawsuits**

Many third-party claims against auditors are baseless, despite the numerous opportunities for such litigation. For instance, if a third party sues the auditor on the grounds that the client (the firm being examined) is no longer a viable company, the auditor has no legal standing to defend themselves against such a claim. The sole duty of the auditor is to ensure that the financial statements are presented honestly in light of the established standards of evaluation. Furthermore, audit risk may also be involved in frivolous claims. The danger of an unsuitable audit opinion being expressed on financial statements is known as "audit risk," and it exists

even if the auditor performs the audit to the best of his or her ability. The scenario essentially concerns inaccuracies in financial statements that persist notwithstanding the auditor's compliance with the governing body's auditing regulations. It's just terrible luck when an auditor, for example, chooses a sample of 29 records at random. Private auditors in Ethiopia are subject to legal responsibility and professional ethics requirements, although their data is not statistically valid. The auditor is not to blame because the mistakes result from chance occurrences. Audit failure, on the other hand, is a case in which a lawsuit is warranted because an auditor did not follow the general auditing requirements set by the regulatory accounting organization.

### **2.11. Empirical literature review**

The role of auditors is pivotal in maintaining financial integrity and transparency within any economy. In Ethiopia, the responsibilities and legal liabilities of auditors working in external audit firms are of particular importance due to the country's evolving regulatory environment and increasing complexity of business operations. This literature review explores various empirical studies related to auditors' professional responsibilities and legal liabilities, with a focus on the Ethiopian context.

#### **Professional Responsibilities of Auditors**

##### **Adherence to Professional Standards**

Empirical studies have shown that adherence to professional standards, including auditing principles and ethical guidelines, is crucial for the credibility of financial statements. Alemayehu and Getachew (2016) conducted a survey among Ethiopian external auditors and found that a significant proportion of auditors are aware of International Standards on Auditing (ISA) and the Code of Ethics for Professional Accountants. However, practical challenges, such as limited resources and insufficient training, often hinder full compliance with these standards.

##### **Ethical Responsibilities**

Research by Wondimagegn and Sintayehu (2018) highlights that ethical behavior among auditors is fundamental to maintaining public trust. Their study, which involved interviews with auditors from major Ethiopian firms, revealed that ethical dilemmas are common, particularly in relation to client relationships and pressure to compromise on audit quality.

The findings suggest a need for stronger enforcement of ethical guidelines and ongoing ethical training.

### **Quality of Audit Work**

The quality of audit work is another critical area of professional responsibility. A study by Teshome (2017) evaluated the audit quality in Ethiopia by assessing audit reports and found varying degrees of compliance with auditing standards. Factors influencing audit quality included auditors' expertise, workload, and the size of the audit firm. Smaller firms, in particular, struggled with maintaining high-quality audits due to resource constraints.

### **Legal Liabilities of Auditors**

#### **Legal Framework**

Ethiopia's legal framework governing auditors includes provisions under the Commercial Code and specific regulations for the accounting and auditing profession. According to Tegegne (2019), while the framework establishes the foundational legal responsibilities, enforcement is often inconsistent. The study analyzed court cases involving auditors and found that legal consequences for professional negligence are rarely pursued, pointing to gaps in regulatory oversight.

#### **Liability for Negligence and Fraud**

Liability for negligence and fraud is a significant concern for auditors. Solomon and Hailemariam (2020) investigated instances where auditors were held accountable for failing to detect financial misstatements. Their research indicated that although there are legal mechanisms to hold auditors liable, practical enforcement is weak. The study calls for stricter legal repercussions and better regulatory mechanisms to ensure auditors are held accountable.

#### **Impact of Legal Liabilities on Audit Practices**

The potential for legal liabilities influences audit practices significantly. A study by Bekele (2018) explored how the fear of legal repercussions affects auditors' behavior in Ethiopia. The findings suggest that auditors often adopt conservative approaches, sometimes over-auditing to mitigate risks of litigation. This cautious approach, while reducing legal risks, can lead to inefficiencies and increased audit costs.

## **Challenges in Implementation**

### **Resource Constraints**

Resource constraints are a pervasive challenge affecting auditors' ability to meet professional and legal obligations. A survey conducted by the Ethiopian Institute of Certified Public Accountants (EICPA) in 2021 revealed that many audit firms lack adequate financial and human resources. This shortage hampers their ability to conduct thorough audits and comply with legal requirements.

### **Regulatory Ambiguities**

Ambiguities in the regulatory framework also pose significant challenges. According to a study by Mesfin (2019), auditors often face difficulties interpreting and applying regulations due to unclear guidelines and frequent changes in legislation. The research suggests the need for clearer, more consistent regulatory policies and better communication from regulatory bodies.

### **Impact on Financial Reporting Quality**

#### **Correlation between Auditor Responsibility and Reporting Quality**

Several empirical studies have examined the link between auditors' professional responsibilities and the quality of financial reporting. For instance, Abebe and Fikadu (2020) found a strong correlation between adherence to auditing standards and the accuracy of financial statements. Their analysis of audit reports from Ethiopian firms indicated that higher compliance levels were associated with fewer financial misstatements and greater investor confidence.

### **Consequences of Non-compliance**

The consequences of non-compliance with professional standards and legal obligations can be severe, impacting the overall financial reporting quality. A report by the World Bank (2019) highlighted cases where audit failures led to significant financial losses and eroded public trust in the financial system. The report emphasizes the need for robust enforcement mechanisms to ensure compliance and protect stakeholders.

## **Regulatory Framework and Oversight**

### **Effectiveness of Regulatory Bodies**

The effectiveness of regulatory bodies in Ethiopia, such as the Office of the Federal Auditor General (OFAG) and the Accounting and Auditing Board of Ethiopia (AABE), is crucial for ensuring auditor accountability. Research by Yohannes (2021) suggests that while these bodies have made strides in improving audit quality, challenges remain in terms of resource allocation and enforcement capabilities.

### **Areas for Improvement**

Identifying areas for improvement in the regulatory framework is essential for enhancing audit quality. A study by Lemma (2020) recommends several measures, including increasing funding for regulatory bodies, enhancing auditor training programs, and implementing stricter penalties for non-compliance. These steps are necessary to build a more robust auditing environment in Ethiopia.

#### **2.12 Auditing History in Ethiopia.**

The primary goals of government auditing include providing informed judgments on financial accounts and related issues concerning legality, regularity, and fraud, as well as assessing the economy, efficiency, and effectiveness of government entities. To achieve these goals, each country establishes a supreme audit institution (SAI), protected by legal provisions to ensure its independence. In Ethiopia, the origins of its supreme audit institution (SAI) date back to the 1931 constitution, which emphasized the importance of proper government revenue collection and regulated spending. However, this constitution did not mandate government auditing or the establishment of an SAI (OFAG, 2023).

The establishment of Ethiopia's initial legally recognized audit institution began with the Audit Commission under Proclamation No. 69 of 1944. This commission was responsible for auditing the Ministry of Finance's financial records, while the Ministry itself inspected and controlled other ministries' financial activities. The Controller and Auditor General led the commission, reporting directly to the Prime Minister. Despite the creation of this audit organization, the commission lacked professional autonomy from the ministry, and its audit scope was limited to specific government departments. These shortcomings were addressed by the revised Proclamation No. 79 of 1946, which consolidated government account

auditing into a single Audit and Control Department, still led by the Controller and Auditor General and reporting to the Prime Minister. The lack of independence persisted, however, compromising the commissioner's autonomy from the executive branch. This department continued until its merger with the Ministry of Finance's control department in 1952, a move unmanaged by legislation and hindering the establishment of a self-governing national audit institution (OFAG, 2023).

The amended constitution of 1955 marked progress by establishing a somewhat autonomous audit organization through Articles 120 and 121, which created an independent auditing body accountable to both the emperor and parliament. These articles required the auditor general to report periodically on government fiscal activities and granted access to all relevant documents and records. Despite these advancements, the specific powers and reporting obligations of the Office of the Auditor General were not detailed until the enactment of Decree No. 32 of 1958, followed by Proclamation 179/1961. This proclamation defined the auditor general's authority, selection criteria, and reporting protocols, enhancing the office's autonomy in regularity audits but not extending to performance or value-for-money audits. Proclamation No. 164/1979 later expanded the office's scope to include efficiency and effectiveness audits (performance audits) but fell short in addressing the reporting and remuneration aspects crucial for a fully functional SAI (OFAG, 2023).

### **2.13. Knowledge Gap**

While some research has been conducted on auditors' professional responsibility and legal liabilities globally, there exists a noticeable knowledge gap specific to the Ethiopian context. The following areas highlight the gaps in existing knowledge that warrant further investigation:

#### **1. Limited Exploration of Ethiopian Regulatory Framework**

Existing literature lacks in-depth exploration of the specific regulatory framework governing auditors' professional responsibilities and legal liabilities in Ethiopian external audit firms. Understanding the intricacies of Ethiopian regulations is essential for comprehending how auditors navigate their roles and the potential legal consequences they may face.

#### **2. Scarcity of Studies on Auditors' Adherence to International Standards in Ethiopia:**

While there is a growing body of literature emphasizing the importance of international auditing standards, there is a knowledge gap regarding the extent to which auditors in Ethiopian external audit firms adhere to these standards. Examining the practical application

of international standards in the Ethiopian context can provide insights into the challenges and areas for improvement.

### 3. Limited Research on Client Influence in Ethiopian Audit Practices

The influence of clients on the audit process and the formulation of financial statements is an underexplored area in the Ethiopian context. Understanding how client interests impact auditors' professional responsibilities and the subsequent legal implications remains a knowledge gap that requires focused investigation.

### 4. Insufficient Exploration of Illicit Audit Activities and Legal Liabilities:

The literature lacks a comprehensive analysis of the engagement of auditors in illicit audit activities and the subsequent legal liabilities they may face in Ethiopian external audit firms. Investigating specific instances, consequences, and patterns of such activities can contribute significantly to the understanding of auditors' legal challenges.

### 5. Limited Focus on the Role of Professional Skepticism and Ethical Decision-Making in Ethiopia:

The literature does not sufficiently address the role of professional skepticism and ethical decision-making in the context of Ethiopian external audit practices. Exploring how these factors mediate the relationships between professional responsibilities, legal liabilities, and audit outcomes is crucial for a comprehensive understanding.

### 6. Understudied Moderating Factors:

The research literature lacks in-depth exploration of moderating factors such as the impact of regulatory oversight and institutional pressures in the Ethiopian audit landscape. Understanding how these factors interact with auditors' limitations and adherence to professional standards is essential for a nuanced comprehension of the dynamics at play.

Addressing these knowledge gaps through empirical research will not only contribute to the academic understanding of auditors' professional responsibility and legal liabilities but also offer practical insights for auditors, regulators, and policymakers in Ethiopia.

## **Conceptual Framework**

### **1. Independent Variables**

#### **A. Adherence to Professional Standards**

- Measurement of auditors' compliance with international auditing standards, ethical guidelines, and professional codes of conduct.

#### B. Client's Influence on Financial Statements

- Evaluation of the degree to which client interests impact the audit process, emphasizing the role of the client in the formulation of financial statements.

#### C. Engagement in Illicit Audit Activities

- Identification and categorization of auditors involved in activities contrary to professional and legal standards.

#### D. Limitations Faced by Auditors

- Exploration of constraints and challenges faced by auditors in fulfilling their professional responsibilities, such as resource limitations or unclear regulatory frameworks.

#### E. Auditors' Liability and Client Connection

- Measurement of the perceived connection between auditors' legal liabilities and their relationship with clients, considering legal principles governing this association.

### **2. Dependent Variables**

#### A. Quality of Financial Reporting

- Assessment of the accuracy, reliability, and completeness of financial statements audited by external auditors.

#### B. Legal Liabilities Faced by Auditors

- Identification and categorization of legal liabilities faced by auditors, including litigation, regulatory penalties, or other legal consequences.

The conceptual framework proposes relationships and interactions among these variables to provide a holistic understanding of the dynamics surrounding auditors' professional responsibility and legal liabilities within Ethiopian external audit firms. The framework will guide the research in examining the intricate connections between these elements and their collective impact on the audit process and outcomes.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3. Introduction**

The research methodology encompasses various components, including the study design, research approach, sample methodologies, source of data, and sampling units. A comprehensive examination of these topics was provided in the subsequent section.

#### **3.1. Research design**

The present study used a descriptive research design. This type of research is employed to facilitate the collection of data from diverse sources and subsequently analyze and interpret it from a certain standpoint. The objective of this study was to provide a comprehensive description and determine the prevalence of the observed events.

#### **3.2 Research Approach**

Creswell (2009) posits that there are three distinct research approaches, namely quantitative, qualitative, and hybrid methods. In this research endeavor, a hybrid methodology was employed. The utilization of a mixed-methods approach in research involves the researcher relying on pragmatics to establish knowledge claims (Creswell, 2009). While considering the selection process, it is important to take into consideration the nature of the research problem or difficulties being addressed, despite the fact that each strategy has its own purpose and application time. Therefore, taking this into consideration, the present study employed a mixed research methodology.

#### **3.3. Target Population**

The target population of the study was private auditors which are legally registered as an auditor with AABE and auditee (organization to be audited) located in Addis Ababa.

#### **3.4. Sampling Unit**

The study focused on a target group consisting of managers, staff from external audit firms, and clients of both private and governmental institutions. Based on the findings of the Association of Accountancy Bodies in Ethiopia (AABE), it is projected that by the year 2023, the number of audit companies operating in Ethiopia will reach a total of 217. Hence, the target population of this study comprised 217 audit businesses and their respective customers.

### **3.5. Sampling Technique and Size**

The sampling technique employed in this study was a multi-stage approach that integrated both purposive and cluster sampling methods. Cluster sampling was initially utilized to group the auditees (organizations to be audited) based on their business types. Subsequently, purposive sampling was applied to select specific auditees from each cluster, ensuring representation. Additionally, purposive sampling was employed to choose a sample of private auditors from the overall auditor population and to conduct interviews with key personnel from various organizations.

To implement this technique, the study categorized the entire population (clients) into five clusters, encompassing the hotel and tourism, construction sector, manufacturing sector, service sector, and non-profit organizations. Within the hotel and tourism cluster, comprising hotels and tour companies, the researcher established criteria for selection, including factors such as the year of establishment, profitability, number of branches, and overall activity. Following these criteria, two organizations were selected from each category within the hotel and tourism sector, resulting in a total sample representative of four organizations.

Similar criteria were applied to the second and third cluster, which included companies from the construction, manufacturing, and service sectors, respectively. The selection process aimed to ensure a diverse and representative sample for a comprehensive study.

The study involved a total sample size of 104 individuals from various organizations. Among them, 39 participants were sourced from different sectors, comprising 13 from hotel and tourism, 13 from the construction sector, and 13 from non-profit organizations. Additionally, the researcher incorporated 65 audit firms featuring private auditors situated in Addis Ababa, with a total of 65 respondents from these firms.

The auditors were actively involved in completing the questionnaires relevant to the study area. Specifically, 104 questionnaires were distributed to individuals across different organizations. Simultaneously, interviews were conducted with key figures, including the general manager of the Ethiopian Accounting and Auditing Board, eight legal officers, and three tax officers from the Ethiopian Revenues and Customs Authorities.

### **3.6. Source of Data and Data Collection**

In order to conduct an analysis, the researcher utilized a combination of primary and secondary data sources. The collection of primary data was conducted utilizing various methods, including the administration of a questionnaire and conducting interviews. The questionnaires were designed to include both open-ended and closed-ended questions that are

pertinent to the topic under investigation. The researcher used a secondary source of data, obtained through a review of selected materials such as the Office of Federal Auditors-General (OFAG). This data was used to identify the sources and audit requirements mandated by international and local organizations. Additionally, it was used to infer the professional and legal responsibilities and rationale of auditors.

### **3.7. Data Analysis**

The subsequent step after data collection that involved the utilization of statistical techniques, namely frequency and percentage methods, to analyze the data. This process entails examining, manipulating, and modeling the data in order to extract valuable insights or facilitate decision-making. According to Kothari (2004), analysis pertains to the calculation of specific metrics and the identification of patterns of associations within sets of data. In order to derive utility, the amassed data undergone a process of analysis and interpretation that is both meaningful and purposeful. The utilization of descriptive statements and percentages were employed in the process.

### **3.8. Reliability and Validity**

To ensure the reliability and validity of the research findings, several measures have been implemented in the data collection process for this study. Nunnally (1978) recommends that Cronbach's alpha ideally should surpass 0.700, although certain studies deem values as low as 0.600 acceptable (Gerrard, et al., 2006). According to Hair, et al. (2006), a Cronbach's alpha exceeding 0.7 indicates strong reliability, while a value below 0.3 implies low reliability. To evaluate the consistency reliability of the instrument, the questionnaire was distributed to 10 different groups of manufacturing enterprises, yielding the following Cronbach's alpha:

#### **3.8.1. Reliability**

Reliability refers to the consistency and stability of the research instrument in producing similar results when used under similar conditions. In this study, reliability was ensured through the following measures:

1. **Test-Retest Reliability:** A pilot study was conducted with a small sample of respondents to assess the consistency of responses over time. The questionnaire was administered to the same respondents with a time interval, and the responses were compared for consistency.

2. Internal Consistency: Cronbach's alpha coefficient was calculated for scales or constructs involving multiple items to measure internal consistency reliability. Items within each scale were expected to correlate highly with each other, indicating reliability.

Table 3.1 summary of Reliability

Independent Variables	Cronbach's Alpha	Number of Items
Audit Quality	.835 5	5
Financial Reporting Reliability	.750	5
Stakeholder Trust	.858	4
Legal Compliance	.862	5
Ethical Conduct	Cronbach' Alpha	Number of Items

Source field survey 2023

### 3.8. Ethical consideration

The research adhered to several significant ethical principles. Respect for persons, non-maleficance (do no damage), beneficence (do well), informed consent, confidentiality, honesty, and the avoidance of plagiarism comprise these principles. Throughout the research process, the researcher took great care not to violate ethical issues that are deemed negative and to uphold ethical issues that are deemed positive.

Reliability and

## **CHAPTER FOUR**

### **DATA ANALYSIS AND PRESENTATION**

#### **Introduction**

This Chapter deals with result and discussion of the study; In order to address the extent to which private auditors exercise their professional and legal responsibilities, and the extent to which the client prepare financial statements for easy verification. Moreover, it designed to explore the responsibility of directors (management) and auditors with regard to financial statements and subsequent to the discovery of misstatements to the audited financial statement.

#### **4.1. Descriptive analysis of the study**

In order to achieve the objective of the study; the researcher used both cluster and purposive sampling; cluster sampling was used to classify different organizations which are operating in the same sector as a group; while purposive sampling was used to select a sample of organizations from each cluster in order to represent the total population; additionally interview was conducted from the general manager of Ethiopian board of accounting and auditing, legal officers and three tax officers in Ethiopian revenue and customs authority.

At the same time information obtained from secondary sources such as reports and related forms, action were analyzed by using different tools like simple tabulation percentage and simple statement. The researcher has distributed 39 questionnaires to respondents but only 36 questionnaires were returned and the rest of three respondents did not return the questionnaire. As it can be discussed in the following subsections of the chapter; the study was targeted two groups as a population, the first group was a client which are combined from different sectors; in this case, 39 respondents were included as a sample size, questionnaire was distributed to them and only 36 of respondents return back the questionnaire. While the second group was private auditors found in Addis Ababa, the sample size of this group was 65, but only 65 of them gave responses to the questionnaire distributed. Additionally, an interview was conducted with 12 personnel combined from different offices.

## 4.2. Demographic characters of respondents (Clients)

To start the basic part of the study it is appropriate to know the characteristics such as educational background and gender of respondents; in line with the data collected from the clients; the following figure shows the distribution related to educational level and gender of respondents.

**Table: 4. 1: Educational level and Gender Distribution of the Respondents**

Parameter	Frequency	Percent
Level of education		
MA/MSc	53	31.57%
BA/BSc	47	63%
Diploma	1	5%
Total	101	100
Sex		
Male	73	63%
Female	28	36.84%
Total	101	100%

Source: researcher own computation

The provided data presents the distribution of respondents based on their level of education and gender. Let's analyze each parameter individually. The majority of respondents (63%) hold a Bachelor's degree (BA/BSc), while a significant portion (31.57%) has pursued higher education, specifically Master's degrees (MA/MSc). A small percentage (5%) has completed diploma-level education. This indicates a diverse educational background among the respondents, with a substantial representation of individuals holding Bachelor's degrees and a notable presence of those with Master's degrees.

The gender distribution among the respondents shows that 63% are male, while 36.84% are female. The data suggests a higher participation of males in the study compared to females, indicating potential gender imbalances in the sample.

The educational diversity, with a significant number of participants holding Bachelor's and Master's degrees, suggests a well-educated and potentially professionally diverse sample. The gender distribution highlights a notable difference in the number of male and female

respondents, raising awareness of potential gender-related considerations in the analysis and interpretation of study results.

It's crucial to be mindful of these demographic factors when drawing conclusions or generalizing findings, as they may influence the perspectives and experiences of the participants. Further exploration and subgroup analysis may be beneficial to uncover potential nuances within the data based on education levels and gender.

### **4.3. Responses from Clients concerning as to what Extent Ethiopian Private Auditors are Exercising Professional and Legal Responsibilities**

#### **4.3.1. Independence**

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

**Table: 4. 2: Respondents response to auditor’s independence**

Statement	Level of agreement					
		SA	A	N	SD	D
Auditors are independent from their clients in all matters	Frequency	16	69	6	7	3
	Frequency %	15.84	68.31	5.94	6.93	2.97

Source: researcher own computation

The provided data represents responses to a statement regarding the perceived independence of auditors from their clients. Substantial majorities (84.15%) of respondents either strongly agree or agree that auditors are independent from their clients in all matters. A small percentage (5.94%) remains neutral on the statement, indicating a level of uncertainty or lack of a clear stance. A combined 9.9% of respondents express disagreement (2.97%) or strong disagreement (6.93%) with the notion of auditors' complete independence from clients.

The high percentage of agreement suggests a general perception among respondents that auditors maintain independence in their dealings with clients. The neutral responses may indicate a need for further clarification or exploration of the concept of independence, as some respondents may not hold a definitive opinion. The minority expressing disagreement

or strong disagreement suggests a divergence in perspectives, and it would be valuable to explore the reasons behind these opinions through additional qualitative research or follow-up questions.

Overall, the analysis provides insights into the prevailing attitudes toward auditor independence among the surveyed population, offering a foundation for deeper exploration and discussion in the context of auditing practices.

On the other hand, the interview was conducted with some personals of Ethiopian accounting and auditing board and number of tax officers of Ethiopian revenue and customs authority in order to get detail information about independence of auditors from their clients. The majority of the respondents responded as saying that; in all aspects, private auditors were independent of their clients. But, one tax officer of the Ethiopian revenue and customs authority does not agree on this, by giving an indication of that; most of the case, private auditors loss independence in terms of soliciting clients, negotiating audit fee, and giving an opinion. The data collected through the questionnaire as well as interview shows there is a disagreement by some respondents regarding the independence of the auditors; so it's an indication for further assessment on the study area. In line with this, as stated in the article of Tesfaye Mengasha, on the capital weekly newsletter," bidding/tendering cited on muluneh (2007). From the above overall analysis of the data; the researcher concluded that private auditors in Ethiopia were independent in their audit activity but there could be an occasion where private auditors by force or interest can violate the principle of auditor's independence from their clients in conducting an audit activity.

#### 4.3.2 Competence

The audit organization needs to command the range of skills and experience necessary for the effective discharge of the audit mandate. Whatever the nature of the audit to be undertaken under that mandate, persons whose education and experience is commensurate with the nature, scope, and complexities of the audit task should carry out the audit activity. The survey result is shown in this regard as follows:

**Table: 4. 3: Respondents response to auditor's competence**

Statement		Agreement scale				
		SA	A	N	SD	D
Auditors have skill sand competency of in performing audit activity	Frequency	21	73		5	2
	Percentage	20.79	72.2		4.95	1.98

Source: researcher own computation

The provided data represents responses to a statement regarding auditors' skills and competency in performing audit activities. The majority of respondents (92.99%) either strongly agrees or agrees that auditors possess the necessary skills and competency for performing audit activities. A small percentage (4.95%) remains neutral on the statement, indicating a level of uncertainty or lack of a clear stance. A combined 1.98% of respondents express disagreement (1.98%) with the auditors' perceived skills and competency.

The high percentage of agreement suggests a strong belief among respondents that auditors have the requisite skills and competency for their audit responsibilities. The neutral responses may prompt further exploration to understand the reasons behind respondents' uncertainty or lack of a definitive opinion. The low percentage of disagreement indicates a generally positive perception of auditors' skills and competency, with only a small minority expressing reservations.

Overall, the analysis provides insights into the perceived competence of auditors in the surveyed population, indicating a generally positive view of their skills and competency in performing audit activities.

On the other hand; the question was provided for the respondents what kind of decision they have taken when incompetent auditors faced them; most of them responded as saying; the number of auditors which incompetent are BA degree holders, in this case, we inform the audit firms and directly change that person with other experienced auditors. Additionally, the result of interview responses revealed that; most of the time individual auditors hold B.A degree and above in accounting profession in order to perform audit work is incompetent and this makes the level of audit practice danger. Thus, in accordance with the data collected and interview results, the researcher concluded that most private auditors in Ethiopia are professionally trained and competent except on some occasions (see appendix number 6).

#### **4.3.3 Audit Work Plan and Supervision**

The auditor should plan the audit work in a manner which ensures that an audit of high quality is carried out in on time, an economic, efficient and effective way. The data collected with regard to the audit work plan and supervision is shown in the table below:

**Table: 4. 4: Respondents response to the audit work plan and fieldwork supervision**

Statement		Agreement scale				
		SD	D	N	A	SA
The auditors prepared an audit work plan, and mandatory supervision was provided by audit firms.	Frequency		27	1	73	
	Percentage		26.73	0.99	72.27	

Source field survey 2023

The statement presents data related to the preparation of an audit work plan by auditors and the provision of mandatory supervision by audit firms. The majority of respondents (72.27%) agree that auditors prepared an audit work plan and received mandatory supervision from audit firms. Relatively small percentages (0.99%) disagree with the statement, suggesting that the majority of participants perceive the audit work plan preparation and supervision by audit firms as appropriate.

The high percentage of agreement implies a general acceptance and approval of the audit work plan preparation and supervision by audit firms. The disagreement from a small percentage of respondents could signal potential concerns or variations in opinions within the surveyed group.

In summary, the majority of respondents agree that auditors prepared an audit work plan and received mandatory supervision from audit firms, but further details on neutral responses and reasons for disagreement would enhance the overall analysis.

Furthermore, the entire interviewee responses depicted the same conclusion; which shows that; the auditors have properly planned their work and the senior auditors frequently supervise the field of auditors. Hence, the analysis of the overall data shows that private auditors adequately plan their audit work and frequently supervise the work of field auditors

#### **4.3.4: Due Professional Care**

The researcher also tried to identify whether the auditor exercise due professional care or not. In this regard, the data collected from the respondents summarized hereunder.

**Table: 4. 5: Respondents response to auditor’s due professional care exercise**

Statement		Yes	No
Auditors exercise due professional care.	Frequency	76	25
	Percentage	75.24	24.75

Source: researcher own computation

The statement under consideration is related to auditors exercising due professional care. The data is presented in a binary format, with respondents indicating whether they believe auditors do exercise due professional care. The majority of respondents (75.24%) believe that auditors do exercise due professional care. Notable but smaller percentages (24.75%) of respondents express the opinion that auditors do not exercise due professional care.

The positive response from the majority indicates a generally favorable view of auditors' commitment to exercising due professional care. The dissenting opinions may indicate areas where improvements or communication efforts could be directed to address any perceived shortcomings in the audit process.

In summary, the majority of respondents express confidence in auditors exercising due professional care. However, the presence of a non-negligible proportion disagreeing with the statement highlights the importance of understanding and addressing any concerns to maintain and enhance trust in the auditing profession.

The interview conducted from the respondents indicates the same conclusion about the importance of due professional care during conducting audit work. Thus, both preparation of financial statements, which is the responsibility of the management of the client; and examination of the financial statements, which is the responsibility of the auditor’s need exercising due professional care (see appendix number 8).

#### **4.3.5 Internal Control Structure**

The study also tried to clarify whether private auditors examine the internal control structure of an audited entity. The survey with regard to internal control structure is summarized as follows.

**Table: 4. 6: Respondent’s response to the internal control structure**

Statement		Agreement scale				
		SD	D	N	A	SA
Private auditors in Ethiopia examine the internal control structure of an audit organization.	Frequency		17	4	68	12
	Percentage		16.83	3.96	67.32	11.88

Source: researcher own computation

The statement revolves around the involvement of private auditors in Ethiopia in examining the internal control structure of an audit organization. The largest portion of respondents (67.32%) remains neutral on the statement, indicating a lack of clear agreement or disagreement regarding private auditors examining the internal control structure of an audit organization. A relatively small percentage (16.83%) strongly disagrees, while 3.96% express disagreement. On the positive side, 11.88% agree with the statement.

The neutral response from the majority may indicate a need for clarification or communication regarding the role of private auditors in evaluating internal control structures. The disagreement from a combined 20.79% of respondents suggests that there may be skepticism or concerns regarding the appropriateness or effectiveness of private auditors in this specific context.

In summary, the neutral stance of the majority and the presence of disagreement suggest a need for clarification and communication about the involvement of private auditors in examining the internal control structure of audit organizations in Ethiopia. Addressing concerns and providing more information could contribute to a more informed and consensus-based perspective among respondents.

On the other hand, a number of considerable respondents responded as saying neutral about the issue. Similarly, the result of the interview shows that; examining the internal control structure of an organization under audit helps to evaluate the extent of sampling, tests of the documents in order to gather sufficient evidential matter to express an opinion. Based on this fact, the researcher concludes that; examination or evaluation of client internal control system helps the auditor in gathering the important information for the expression of an opinion. From the data collected with this regard, it is possible to understand that; most of the private auditors in Ethiopia conduct or examine the internal control structure of the companies, but,

since there are a number of respondents those do not agree with this, it needs further investigation on the issue

#### 4.3.6 Evidence

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

#### 4.3.7 Reporting Standards

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

**Table: 4. 7: Respondent’s response to principles followed by auditors**

Statement		Yes	No
Auditing standards are applied in the preparation of the financial statements, and auditors also follow that principle in examining audit activity.	Frequency	83	19
	Percentage	82.17	18.81

Source: researcher own computation

The statement in question pertains to the application of auditing standards in the preparation of financial statements, with auditors following this principle when examining audit activities.

A substantial majority of respondents (82.17%) agree that auditing standards are applied in the preparation of financial statements, and auditors also adhere to this principle when examining audit activities. Notable but smaller percentages (18.81%) express disagreement with the statement.

The high level of agreement implies a general adherence to professional standards and practices within the auditors surveyed, fostering confidence in the integrity of financial

reporting and audit activities. The minority of respondents disagreeing may raise questions about potential challenges or concerns in the implementation of auditing standards within certain contexts.

In summary, the majority of respondents express confidence in the application of auditing standards in the preparation of financial statements and during the examination of audit activities. Addressing concerns from the minority and maintaining ongoing training and communication initiatives can contribute to a robust and consistent application of auditing standards across the auditing profession.

Regarding to open-ended question, the respondents were asked to specify other principles followed by auditors in conducting audit activity in their companies if not GAAS; and almost all respondents responded as saying, in current situation after international financial reporting standards become a mandatory principle that should have to be followed in preparing financial statements; also, international auditing standards are followed in line IFRS for the sake of financial auditing. So, they have started to use international auditing standards as a principle in auditing financial statements; which is, in line with the new financial proclamation of 2016; which commands all companies found in Ethiopia to prepare their financial statement in accordance with international financial accounting standards. In this case, the auditors conduct their audit examination based on international audit standards. The result of the interview also showed a mixed justification on the principles used in preparing financial statements and examining audit. According to the interviewee, the reason behind for mixed answer is in that; most companies in Ethiopia do not start to use international financial accounting standard as a base in preparing financial statements, and this is because of the length of time it takes to convert all data to IFRS. From the above finding, it is possible to conclude that; the private auditors in Ethiopia have previously followed the principle that was based on generally accepted but because of change in financial proclamation; presently they base their principle on international audit standards

**Table: 4. 8: Respondents response on materiality principle**

Statement		Agreement scale				
		SD	D	N	A	SA
Auditors follow the materiality of information when disclosing it to the users of the report.	Frequency	14	3	5	68	11
	Percentage	13.86	2.97	4.95	67.32	10.89

Source field survey 2023

The statement discusses auditors' adherence to the principle of materiality when disclosing information to users of the report. The majority of respondents (78.21%) express agreement or strong agreement with the statement, indicating that auditors generally follow the principle of materiality when disclosing information to users of the report. Smaller percentages (17.83%) either disagree or strongly disagree with the statement, while a small portion (4.95%) remains neutral.

The high percentage of agreement suggests a general consensus among respondents that auditors appropriately consider materiality when disclosing information, contributing to the reliability and relevance of the audit report. The neutral and disagreement responses may point to areas where further clarification or communication is needed to enhance understanding or address concerns.

In summary, the majority of respondents agree that auditors follow the materiality principle when disclosing information to users of the report. Addressing any remaining uncertainties or concerns could further enhance stakeholders' confidence in the audit process and the information provided in audit reports.

On the other hand, the interview response showed that even though the error obtained was immaterial, the long run effect of the information on the going concern was taken in to account to disclose in the report. Additionally, they added that such immaterial information was reported on the management letter for internal control purpose and in order to eliminate the long run effect of it. From this, the researcher concludes that; private auditors in Ethiopia were properly planning and performing the audit so as to obtain sufficient evidence to give reasonable assurance that the financial statements of the client are free from material misstatements.

#### **4.3.8 Contractual Agreement**

The second part of this section deals with the auditors legal responsibilities with regard to the examination of the financial statements of the audit client's from the point of view of both clients and auditors.

**Table: 4. 9: Respondents response on a contractual agreement**

<b>Statement</b>		<b>Yes</b>	<b>No</b>
Signing a contractual agreement is mandatory, outlining the audit scope, auditor qualifications, duration, management and auditor responsibilities, audit fees, and more.	Frequency	84	17
	Percentage	83%	16.8%

Source field survey 2024

The data presented indicates that the majority of respondents, accounting for 83% of the total, agree that signing a contractual agreement is mandatory to outline various aspects of the audit process. This suggests a strong consensus among respondents regarding the necessity of formalizing agreements to establish clarity and expectations in audit engagements.

Conversely, 16.8% of respondents disagree with the statement, indicating a minority perspective. While this dissenting viewpoint may represent varying interpretations of contractual requirements or preferences for informal arrangements, it suggests the existence of a subset of respondents who perceive contractual agreements as optional or unnecessary in certain audit contexts.

Overall, the high frequency of affirmative responses underscores the perceived importance of contractual agreements in delineating the audit scope, responsibilities, and other pertinent details. This highlights a widespread understanding among respondents regarding the significance of formal documentation in facilitating effective audit processes and mitigating potential misunderstandings or disputes.

#### 4.3.9 Contractual Obligation

A contractual obligation is something that you are required to do because you have agreed to it by way of a legally binding contract (whether in writing or verbal). So once, the auditor signs a contractual agreement with its clients. The auditor has the obligation to perform that activates. With regard to a contractual obligation, the following figure shows the responses of respondents.

**Table: 4. 10: Respondents response to auditor’s contractual responsibility**

Statement		Agreement scale				
		SD	D	N	A	SA
Auditors are responsible for contractual agreements made between the client and the auditor	Frequency		14	5	65	17
	Percentage		13.8	4.95	64	20.7

Source field survey 2024

The data illustrates varying degrees of agreement with the statement "Auditors are responsible for contractual agreements made between the client and the auditor," as indicated by respondents' ratings on a five-point agreement scale.

A significant portion of respondents (64%) expressed a neutral stance (N) towards the statement, suggesting uncertainty or lack of strong conviction regarding the extent of auditors' responsibility in contractual agreements. This neutrality may stem from a lack of clarity or differing interpretations regarding the role of auditors in contractual matters.

Meanwhile, a notable percentage of respondents (20.7%) strongly agree (SA) with the statement, indicating a belief that auditors bear substantial responsibility for contractual agreements. This perspective likely reflects an expectation for auditors to actively engage in negotiating, drafting, or reviewing contractual terms to ensure alignment with professional standards and ethical considerations.

On the other hand, a smaller proportion of respondents (13.8%) expressed disagreement (D) with the statement, suggesting a belief that auditors have limited or no responsibility for contractual agreements. This dissenting viewpoint may arise from interpretations of auditors' roles as primarily focused on conducting audits rather than contractual negotiations or legal matters.

Overall, the data highlights a spectrum of perspectives regarding the extent of auditors' responsibility in contractual agreements, with a notable proportion of respondents expressing uncertainty or neutrality on the matter. This variability underscores the complexity and ambiguity surrounding auditors' roles in contractual engagements and suggests a need for further clarification and consensus-building within the auditing profession.

#### 4.3.10 Statutory Obligation

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

**Table 4. 11: Respondents response to auditor’s statutory responsibility**

Statement		Agreement scale				
		SD	D	N	A	SA
Auditors who violate statutory responsibility are legally liable for both to their client and a third party	Frequency		13	2	67	19
	Percentage		12.8	1.9	66	18.8

Source field survey 2024

The data presents responses to the statement "Auditors who violate statutory responsibility are legally liable for both their client and a third party," categorized by an agreement scale ranging from strongly disagree (SD) to strongly agree (SA).

A considerable proportion of respondents (66%) expressed a neutral (N) stance towards the statement, indicating a lack of definitive agreement or disagreement regarding auditors' legal liability in cases of statutory violations. This neutrality may stem from a nuanced understanding of legal complexities surrounding auditor responsibilities and liability, as well as varying interpretations of statutory requirements.

Meanwhile, a notable percentage of respondents (18.8%) agreed (A) with the statement, suggesting a belief that auditors can indeed be legally liable to both their client and a third party in cases of statutory breaches. This perspective likely reflects an understanding of the legal principles governing auditor liability, including obligations to stakeholders beyond the immediate client.

On the other hand, a smaller proportion of respondents (12.8%) strongly disagreed (SD) with the statement, indicating a belief that auditors are not legally liable to both their client and a third party for statutory violations. This dissenting viewpoint may arise from interpretations of legal precedents, professional standards, or contractual arrangements that limit auditors' liability to specific parties or circumstances.

Overall, the data highlights a diversity of perspectives regarding auditors' legal liability in cases of statutory violations, with a notable proportion of respondents expressing neutrality on the matter. This variability underscores the complexity and ambiguity surrounding auditor liability, reflecting the need for continued dialogue, legal clarity, and professional guidance within the auditing profession.

#### **4.4. The responsibilities of management and auditors with regard to the financial statements and subsequent to the discovery of misstatements to the financial statements**

Within corporate organizations, the duties of management and auditors diverge. To delineate the specific responsibilities of management and auditors concerning the preparation of financial statements and the subsequent detection of inaccuracies within the audited financial statements, the researcher investigates the following findings:

#### 4.4.1 Preparation of Financial Statements:

Creating general-purpose financial statements, which encompass the balance sheet, income statement, statement of retained earnings, and statement of cash flows, stands as a pivotal stage in the accounting cycle as it epitomizes the essence of financial accounting. This task primarily falls under the purview of management rather than external auditors. The survey results regarding the entity responsible for preparing financial statements are outlined below.

**Table: 4. 12: Respondent’s response to the preparation of financial statements**

Statement		Yes	No
The management of client organization is responsible for preparing financial statements.	Frequency	89	12
	Percentage	88	11.8

Source: field survey 2024

The data provided indicates a strong consensus among respondents regarding the statement "The management of the client organization is responsible for preparing financial statements."

The majority of respondents, comprising 88% of the total, agree with the statement. This high frequency of affirmative responses underscores a widespread understanding among respondents that the primary responsibility for preparing financial statements lies with the management of the client organization. This acknowledgment aligns with standard accounting practices and regulatory requirements, which typically mandate that management is responsible for accurately presenting the financial position and performance of the organization.

Conversely, a smaller proportion of respondents, representing 11.8% of the total, disagree with the statement. While this dissenting viewpoint exists, it is comparatively minor; suggesting that a small segment of respondents may hold alternative perspectives regarding the division of responsibilities in financial reporting processes.

Overall, the overwhelming agreement with the statement highlights a shared understanding among respondents regarding the fundamental role of management in financial statement preparation. This consensus reinforces the importance of clear delineation of responsibilities and accountability in financial reporting, ensuring transparency and reliability in the presentation of financial information.

#### 4.4.2 Misstatement of Audited Financial Statements

**Table: 4. 13: Respondents response to auditor’s statutory responsibility**

Statement		Yes	No
Private auditors are legally liable for subsequent discovery of misstatement audited financial statements	Frequency	93	8
	Percentage	92	7.9

Source field survey 2024

The data presented indicates a strong consensus among respondents regarding the statement "Private auditors are legally liable for subsequent discovery of misstatement in audited financial statements."

The vast majority of respondents, comprising 92% of the total, agree with the statement. This high frequency of affirmative responses suggests a widespread belief among respondents that private auditors hold legal liability for inaccuracies discovered in audited financial statements after the completion of the audit process. This perspective aligns with legal and regulatory frameworks governing auditing practices, which often impose legal obligations on auditors to ensure the accuracy and reliability of financial statements.

Conversely, a small proportion of respondents, representing 7.9% of the total, disagree with the statement. While this dissenting viewpoint exists, it is comparatively minor, indicating that only a small segment of respondents may hold alternative perspectives regarding the extent of auditors' legal liability for misstatements discovered subsequent to the audit.

Overall, the overwhelming agreement with the statement underscores a shared understanding among respondents regarding the legal responsibilities of private auditors in ensuring the accuracy and reliability of audited financial statements. This consensus reinforces the importance of accountability and professionalism in auditing practices, contributing to investor confidence and financial transparency in the marketplace.

#### 4.5: Responses with Regard to Auditor’s rules of Professional Responsibility

Advertising and solicitation should focus on providing the public with objective information and should be characterized by decency, honesty, truthfulness, and good taste. It is imperative to prohibit solicitation through coercion or harassment. Jack C. Robertson (1990) contends that professional responsibility for auditors extends beyond mere adherence to formal codes of professional conduct. Notably, concepts of appropriate professional behavior are integral

to all aspects of practice. Ethics, along with its associated disciplinary implications, form the basis for self-regulatory endeavors by public accountants (Robertson, 1990). The survey findings regarding this matter are outlined as follows:

#### 4.5.1 Selection of Auditors

**Table: 4. 14: Respondent’s response on criteria for auditor’s selection**

Statement		friendly or family relationship	Advertisement on media	controlling unit	Based on recommendation
The auditors are selected and assigned	Frequency	59	16	17	9
	Percentage	58	15.8	16.8	8.9

The data presented provides insights into the factors influencing the selection and assignment of auditors. Respondents were asked to indicate whether auditors are chosen and assigned based on friendly or family relationships, advertisement on media, controlling unit, or recommendations.

The highest frequency of responses, at 58%, indicates that auditors are selected and assigned based on friendly or family relationships. This suggests a prevalent practice of nepotism or favoritism in auditor selection within the surveyed population. Such a trend may raise concerns about the objectivity and independence of the auditing process, as personal relationships could potentially compromise professional judgment and integrity.

Following closely behind, 15.8% of respondents indicated that auditors are chosen based on advertisements on media. This finding highlights the role of advertising in attracting clients or influencing their choices regarding auditor selection. While advertising can provide visibility and promote expertise, it is essential to ensure that such marketing efforts adhere to ethical standards and do not compromise auditor independence or objectivity.

Similarly, 16.8% of respondents noted that auditors are selected based on recommendations. Recommendations from trusted sources or referrals from previous clients can significantly influence auditor selection decisions, reflecting the importance of reputation and trust in the auditing profession.

A smaller proportion of responses, at 8.9%, indicated that auditors are chosen based on the controlling unit. This suggests that in some cases, auditors may be selected and assigned by an authoritative entity within the organization, such as a board of directors or an audit committee. Such centralized control over auditor selection could help ensure impartiality and adherence to professional standards.

Overall, the data highlights the diverse factors influencing auditor selection and assignment, ranging from personal relationships to professional recommendations and institutional control. Understanding these dynamics is crucial for promoting transparency, accountability, and integrity in the auditing process.

#### 4.5.2 Purpose of Audit Report

To facilitate informed investment, credit rating assessments, business expansion plans, and other decisions, decision-makers depend on the financial data provided by business entities. Their confidence in these financial records increases when they are scrutinized by impartial professional auditors. Considering this viewpoint, the survey aimed to address the following inquiries:

**Table: 4. 15: Respondents response to the purpose of the audit report.**

Statement		For taxation	For creditors or external users	For auditing accounting book is mandatory
Purpose of auditing	Frequency	43	36	22
	Percentage	42.5	35.6	21.7

Source: researcher own computation

The data provided offers insights into the purposes for which auditing accounting books are deemed mandatory, as perceived by respondents. Respondents were asked to indicate whether auditing accounting books is mandatory for taxation purposes, for creditors or external users, or for auditing purposes.

The highest frequency of responses, at 42.5%, indicates that auditing accounting books is considered mandatory primarily for taxation purposes. This suggests that taxation authorities often require businesses to undergo auditing to verify the accuracy of financial records for tax

assessment purposes. Auditing in this context serves to ensure compliance with tax regulations and to prevent tax evasion.

Following closely behind, 35.6% of respondents indicated that auditing accounting books is mandatory for creditors or external users. This finding underscores the importance of audited financial statements in providing assurance to creditors and external stakeholders regarding the financial health and reliability of the business entity. Audited financial statements enhance transparency and credibility, thereby facilitating lending decisions and fostering trust among external stakeholders.

A smaller proportion of responses, at 21.7%, indicated that auditing accounting books is mandatory for auditing purposes. This result may seem somewhat redundant, as auditing itself entails the examination of accounting books and financial records to ensure accuracy, compliance, and reliability. However, it is possible that respondents interpreted this option as referring specifically to external audits conducted by independent auditors, distinct from internal audits conducted by the organization's own staff.

Overall, the data highlights the multifaceted purposes served by auditing accounting books, ranging from regulatory compliance for taxation to enhancing transparency for external stakeholders. Understanding these diverse purposes is essential for recognizing the value and significance of auditing in ensuring the integrity and reliability of financial information.

#### **4.6. Constraints to Private Auditors in Attempting to Exercise their Responsibility**

As mentioned in the literature review section of the study, stakeholders such as investors, creditors, managers, and shareholders require financial information from both their own businesses and competitors to make informed business decisions. They rely on audited financial statements to instill confidence in their decision-making process. Consequently, it falls upon auditors to provide users of audited financial statements with access to the information presented in these statements. However, auditors face various constraints when attempting to fulfill their responsibilities. These constraints were identified through the survey questionnaire and interview results and include, but are not limited to:

**Table: 4. 16: Respondents response to the Audit opinion**

Statement		Yes	No
Audit opinion	Frequency	84	17
	Percentage	83	17

Source: field survey 2024

The data provided indicates respondents' agreement or disagreement regarding the issuance of an audit opinion. A substantial majority of respondents, comprising 83% of the total, indicated agreement with the statement that an audit opinion is provided. This high frequency of affirmative responses suggests a widespread understanding among respondents regarding the standard practice of auditors issuing opinions on financial statements following an audit.

Conversely, a minority of respondents, representing 17% of the total, disagreed with the statement. While this dissenting viewpoint exists, it is comparatively minor; indicating that only a small segment of respondents may hold alternative perspectives regarding the issuance of audit opinions.

Overall, the overwhelming agreement with the statement underscores a shared understanding among respondents regarding the importance of audit opinions in providing assurance to users of financial statements regarding their reliability and adherence to accounting standards. This consensus reinforces the significance of audit opinions as a key component of the auditing process, contributing to transparency and credibility in financial reporting. In this context, Tesfaye Mengasha, as cited in Muluneh (2007), discussed how an audit opinion can be influenced, as detailed in a Capital Weekly newsletter dated July 13, 2003. The subsequent paragraph examines this issue, questioning how two different auditors examining the same bank could arrive at contrasting results, despite dealing with what are typically considered precise figures. Accounting, unfortunately, involves a significant amount of estimation, making an audit primarily an exercise in professional judgment. Both international and local auditors are entitled to their own opinions. However, from an outsider's perspective, such significant discrepancies in results may challenge the notion of differences merely being opinions, especially if the audits are assumed to have similar scopes. This illustrates that despite the application of identical auditing standards by international and local auditors, instances may arise where auditors compromise their professional responsibility. Based on this analysis and discussion, the researcher concludes that there are circumstances in which auditors may engage in negotiations with their clients to alter their opinion.

**Table: 4. 17: Respondents Response on exercising professional and legal responsibility of Auditors.**

Statement		SA	A	N	SD	D
Private auditors in Ethiopia exercise professional and legal responsibility or no	Frequency	6	13	2	14	66
	Percentage	5.9	12.8	1.9	13.8	65

Source field survey 2024

The data provided presents respondents' perceptions regarding the exercise of professional and legal responsibility by private auditors in Ethiopia. The majority of respondents, comprising 65% of the total, expressed disagreement (D) with the statement, indicating a belief that private auditors in Ethiopia do not adequately exercise professional and legal responsibility. This finding suggests a prevailing skepticism among respondents regarding the performance of private auditors in upholding professional and legal standards in their auditing practices.

A notable proportion of respondents, representing 13.8% of the total, strongly disagreed (SD) with the statement. This indicates a particularly strong sentiment of distrust or dissatisfaction with the conduct of private auditors, underscoring concerns about their adherence to professional ethics and legal requirements.

Conversely, a smaller percentage of respondents, at 5.9%, strongly agreed (SA) with the statement, suggesting a minority perspective that private auditors in Ethiopia do exercise professional and legal responsibility adequately. Similarly, 12.8% of respondents agreed (A) with the statement, indicating a broader acknowledgment of deficiencies in the performance of private auditors. Only a minimal percentage of respondents, at 1.9%, expressed neutrality (N) towards the statement. This indicates a lack of strong conviction or uncertainty among a small segment of respondents regarding the extent to which private auditors fulfill their professional and legal responsibilities.

Overall, the data highlights a significant level of skepticism and concern among respondents regarding the performance of private auditors in Ethiopia. This underscores the importance of addressing perceived shortcomings and enhancing accountability and transparency within the auditing profession to maintain public trust and confidence in financial reporting practices.

## 4.7. Responses from Auditor’s concerning as to what Extent Ethiopian Private Auditors are Exercising Professional and Legal Responsibilities.

### 4.7.1. Demographic characters of respondents

In the initial section of this chapter, the examination and interpretation of the demographic attributes of clients were conducted. Subsequently, this section delves into the demographic features of auditors, providing an analysis and presentation as follows.

**Table: 4. 18: Respondents (Auditors) response with regard to their Gender and Educational level**

Parameter	Frequency	Percent
Level of education		
MA/MSc	3	21%
BA/BSc	9	42%
Diploma		24%
Sex		
Male	8	54%
Female	4	54.5%
Total	12	100%

Source: field survey 2024

The data presented outlines the distribution of auditors based on two parameters: level of education and sex.

Regarding the level of education, the majority of auditors, comprising 42%, hold a Bachelor's degree (BA/BSc). This suggests that a significant proportion of auditors have completed undergraduate education, which typically provides a foundational understanding of auditing principles and practices. Following this, 21% of auditors possess a Master's degree (MA/MSc), indicating a smaller but notable segment of auditors with advanced education levels. Additionally, 24% of auditors hold a Diploma, representing another subset of professionals with specialized training in auditing or related fields.

In terms of sex distribution, the data reveals a nearly equal representation of male and female auditors. Specifically, 54% of auditors are male, while 54.5% are female. This suggests a relatively balanced gender ratio among auditors, indicating opportunities for both men and women to pursue careers in auditing.

Overall, the data provides insights into the educational background and gender composition of auditors in the surveyed population. Understanding these demographics is crucial for assessing the diversity and qualifications of auditors within the profession, which can influence audit quality and effectiveness.

**Table: 4. 19: Respondent’s response Related to Irregularity of laws affecting professional responsibility.**

Statement		SA	A	N	SD	D
Absence of a regulatory body to be the most serious challenge within the legislative environment followed by lack of professional responsibility	Frequency	3	6	1		2
	Percentage	25	50	8		16

Source: Researcher own computation

The data provided offers insights into respondents' perceptions regarding the most serious challenges within the legislative environment, with a focus on the absence of a regulatory body followed by the lack of professional responsibility

A significant percentage of respondents, comprising 50% of the total, indicated agreement (A) with the statement. This suggests that a notable proportion of respondents perceive the absence of a regulatory body as the most serious challenge within the legislative environment, followed by the lack of professional responsibility. This viewpoint likely reflects concerns about the potential consequences of inadequate oversight and enforcement mechanisms on the integrity and reliability of financial reporting practices.

Additionally, 25% of respondents strongly agreed (SA) with the statement, indicating a smaller but still considerable segment of respondents who hold a particularly strong conviction regarding the seriousness of these challenges.

Conversely, 16% of respondents expressed disagreement (D) with the statement, indicating a minority perspective that the absence of a regulatory body and the lack of professional responsibility are not the most serious challenges within the legislative environment. Similarly, 8% of respondents indicated neutrality (N) towards the statement, suggesting a lack of strong conviction or uncertainty among a small segment of respondents regarding these issues.

Overall, the data suggests a prevalent concern among respondents regarding the absence of a regulatory body and the lack of professional responsibility as significant challenges within the legislative environment. Addressing these challenges is crucial for promoting transparency, accountability, and ethical conduct in the auditing profession, thereby enhancing trust and confidence in financial reporting practices.

**Table: 4. 20: Respondents response with regard to Fairness of Financial statement**

Statement		SA	A	N	SD	D
The financial statements submitted to stakeholders are a fair presentation of facts of reporting entities	Frequency	3	6		1	2
	Percentage	25	5.9		0.99	1.9

Source: field survey 2024

The data provided pertains to respondents' perceptions regarding the fairness of financial statements submitted to stakeholders by reporting entities. A small percentage of respondents, representing 25% of the total, strongly agreed (SA) with the statement. This suggests that a minority of respondents believe that the financial statements presented to stakeholders by reporting entities provide a fair representation of the underlying facts. Similarly, a small percentage of respondents, at 5.9%, agreed (A) with the statement. This indicates a slightly broader but still limited agreement among respondents regarding the fairness of financial statements.

On the other hand, only a minimal percentage of respondents, at 0.99%, expressed neutrality (N) towards the statement. This suggests a lack of strong conviction or uncertainty among a small segment of respondents regarding the fairness of financial statements. Additionally, 1.9% of respondents strongly disagreed (SD) with the statement, indicating a minority perspective that the financial statements submitted to stakeholders are not a fair presentation of the reporting entities' facts.

The data highlights a lack of widespread agreement among respondents regarding the fairness of financial statements submitted to stakeholders. This underscores the importance of transparency, accuracy, and adherence to accounting standards in financial reporting practices to ensure the credibility and reliability of financial information for stakeholders.

**Table: 4. 21: Respondent’s response Related to the responsibility of auditors**

Statement		SA	A	N	SD	D
The financial statements submitted to stakeholders are a fair presentation of facts of reporting entities	Frequency	3	6	2		1
	Percentage	25	50	1.9		0.9

Source: field survey 2024

The data provided presents respondents' perceptions regarding the fairness of financial statements submitted to stakeholders by reporting entities. A notable percentage of respondents, comprising 50% of the total, indicated agreement (A) with the statement. This suggests that a significant proportion of respondents believe that the financial statements provided to stakeholders offer a fair representation of the facts pertaining to the reporting entities. Additionally, 25% of respondents strongly agreed (SA) with the statement, indicating a smaller but still substantial segment of respondents who hold a particularly strong conviction regarding the fairness of financial statements. A minimal percentage of respondents, at 1.9%, expressed neutrality (N) towards the statement. This suggests a lack of strong conviction or uncertainty among a small segment of respondents regarding the fairness of financial statements.

Conversely, only a negligible percentage of respondents, at 0.9%, strongly disagreed (SD) with the statement. This indicates a minority perspective that the financial statements submitted to stakeholders do not provide a fair presentation of the reporting entities' facts.

Based on this finding, the researcher concludes that private auditors in Ethiopia prioritize the public interest over their own or the interests of users. However, there is cause for concern, as some private auditors occasionally prioritize their own interests over the public interest when engaging in audit activities.

**Table: 4. 22: Respondent’s response Related to auditors judgment**

Statement		Public interest	Self interest	Audit firm interest	User interest
What kind of judgment they should consider, if a choice of decision is given for auditors.	Frequency	8	1	1	2
	Percentage	66.6	0.9	0.9	1.9

Source: field survey 2024

The data presented provides insights into the factors that auditors should consider when making judgments, particularly when faced with a choice of decision. Respondents were asked to indicate their opinions on whether auditors should prioritize public interest, self-interest, audit firm interest, or user interest in such scenarios.

The majority of respondents, comprising 66.6% of the total, indicated that auditors should consider public interest when making judgments. This suggests a strong consensus among respondents that auditors should prioritize the broader societal welfare and well-being when making decisions, reflecting the importance of transparency, accountability, and integrity in the auditing profession.

Conversely, only a negligible percentage of respondents, at 0.9%, expressed a preference for auditors to prioritize self-interest or audit firm interest when making judgments. Similarly, a minimal percentage of respondents, at 1.9%, indicated a preference for auditors to prioritize user interest.

The data highlights a clear preference among respondents for auditors to prioritize public interest when making judgments. This underscores the ethical and professional responsibility of auditors to serve the public good and uphold the integrity of financial reporting practices. Additionally, it emphasizes the importance of aligning auditing practices with broader societal interests and expectations to maintain public trust and confidence in the auditing profession.

**Table: 4. 23: Respondents response with regard to threats of professional responsibility**

Statement		Self-interest over professional duty	Clients influence through benefit	Audit firm influence	Lack of professional responsibility awareness
threats of professional responsibility of auditors with regard to the individual level of auditors	Frequency	6	3	1	2
	Percentage	66.6	25	0.9	1.9

Source: field survey 2024

The data provided offers insights into the perceived threats to the professional responsibility of auditors at the individual level, as indicated by respondents. Respondents were asked to identify various factors that pose threats to auditors' professional responsibility, including prioritizing self-interest over professional duty, influence from clients through benefits, influence from the audit firm, and lack of awareness of professional responsibility.

A significant majority of respondents, comprising 66.6% of the total, identified the prioritization of self-interest over professional duty as a threat to auditors' professional responsibility. This suggests a widespread concern among respondents regarding the potential for auditors to prioritize personal interests or gain over their professional obligations, which could compromise the integrity and objectivity of their work. Additionally, 25% of respondents cited the influence of clients through benefits as a threat to auditors' professional responsibility. This highlights the perceived risk of auditors succumbing to undue influence or pressure from clients, potentially leading to compromised independence and objectivity in their audit judgments and decisions.

A negligible percentage of respondents, at 0.9%, identified influence from the audit firm as a threat to auditors' professional responsibility. Similarly, 1.9% of respondents cited a lack of awareness of professional responsibility as a potential threat.

The data underscores the importance of recognizing and addressing various threats to auditors' professional responsibility at the individual level. These include not only external pressures from clients and audit firms but also internal factors such as personal interests and awareness of professional obligations. Mitigating these threats is essential for upholding the integrity, independence, and ethical standards of the auditing profession, thereby ensuring the reliability and credibility of financial reporting processes.

**Table: 4. 24: Respondents response with regard to the compliance history of clients**

Statement		SA	A	N	SD	D
One of the safeguards to protect against undue exposure to professional liability is verification of potential clients' compliance history and the nature of business they are engaged in, before taking a professional appointment.	Frequency	3	7	1		1
	Percentage	25	58	0.9		0.9

Source: field survey 2024

The data provided pertains to respondents' perceptions regarding a safeguard against undue exposure to professional liability in the auditing profession.

A notable percentage of respondents, comprising 58% of the total, indicated agreement (A) with the statement. This suggests that a significant proportion of respondents believe that verifying potential clients' compliance history and the nature of their business before accepting a professional appointment serves as an effective safeguard against exposure to professional liability. This indicates a recognition among respondents of the importance of due diligence in assessing potential risks and liabilities associated with client engagements. Additionally, 25% of respondents strongly agreed (SA) with the statement, indicating a smaller but still substantial segment of respondents who hold a particularly strong conviction regarding the efficacy of this safeguard.

On the other hand, only a minimal percentage of respondents, at 0.9%, expressed neutrality (N) towards the statement. This suggests a lack of strong conviction or uncertainty among a small segment of respondents regarding the effectiveness of this safeguard. Similarly, 0.9% of respondents strongly disagreed (SD) with the statement, indicating a minority perspective that verifying potential clients' compliance history and business nature is not an effective safeguard against professional liability exposure.

The data suggests a generally positive perception among respondents regarding the effectiveness of verifying potential clients' compliance history and business nature as a safeguard against undue exposure to professional liability. This underscores the importance of thorough client assessments in mitigating risks and upholding professional standards in the auditing profession.

**Table: 4. 25: Respondent’s response Related to considering clients as a source of revenue**

Statement		Yes	No
Private auditors consider their clients as a source of revenue	Frequency	3	9
	Percentage	25	75

Source: field survey 2024

The data provided presents respondents' perspectives on whether private auditors consider their clients solely as a source of revenue.

A significant majority of respondents, comprising 75% of the total, indicated disagreement (No) with the statement. This suggests a prevailing belief among respondents that private auditors do not view their clients exclusively as sources of revenue. Instead, they likely recognize the importance of maintaining professional integrity, client relationships, and fulfilling their responsibilities to provide accurate and reliable audit services.

Conversely, a minority of respondents, at 25%, agreed (Yes) with the statement. While this perspective exists, it is relatively small, indicating that only a fraction of respondents believe that private auditors prioritize revenue generation over other considerations in their client relationships.

This can be taken from a lesson of Arthur Anderson which is related to a case of Enron, in this case, the clients were considered as the major source of revenue, which is managed to force bending of values to its own interest. Revenue dependence signifies major implication. In this connection, such heavy dependence on a client is likely to create threats to objectivity and or self-interest threats; which directly affect professional responsibility of the profession.

**Table: 4. 26: Respondent’s response with regard to the effect of relationship**

Statement		SA	A	N	SD	D
private auditors consider their clients as a source of revenue	Frequency	3	6			3
	Percentage	25	50			25

Source field survey 2024

The data provided presents respondents' perceptions regarding whether private auditors view their clients primarily as a source of revenue. A significant percentage of respondents, comprising 50% of the total, indicated agreement (A) with the statement. This suggests that a notable proportion of respondents believe that private auditors consider their clients as a primary source of revenue. This viewpoint may reflect concerns about potential conflicts of interest or perceptions of profit-driven motivations among auditors. Additionally, 25% of respondents strongly agreed (SA) with the statement, indicating a smaller but still substantial segment of respondents who hold a particularly strong conviction regarding the perception that private auditors prioritize revenue from their clients.

On the other hand, 25% of respondents expressed neutrality (N) towards the statement. This suggests a lack of strong conviction or uncertainty among a significant segment of

respondents regarding whether private auditors view their clients primarily as a source of revenue.

From this, the researcher concludes a mixed perception among respondents regarding the extent to which private auditors consider their clients as a source of revenue. While a notable proportion of respondents believe that revenue considerations play a significant role in auditor-client relationships, others may hold differing opinions or exhibit uncertainty on the matter. These findings highlight the complexity of dynamics within auditor-client relationships and underscore the importance of ethical considerations and professionalism in the auditing profession.

**Table: 4. 27: Respondent’s response with regard to the concern of clients.**

Statement		Exaggerating expense	Fair Presentation of facts	increasing profit
Concern of clients	Frequency	5	7	
	Percentage	41.6	58	

Source: field survey 2024

The data provided presents respondents' concerns regarding certain behaviors related to financial reporting, specifically the exaggeration of expenses and the fair presentation of facts to increase profit, from the perspective of clients. Respondents were asked to indicate their level of concern regarding these behaviors.

The majority of respondents, comprising 58% of the total, expressed concern about the fair presentation of facts to increase profit. This suggests that a significant proportion of clients are apprehensive about the potential for financial information to be manipulated or misrepresented in order to enhance reported profits. Such concerns likely stem from a desire for transparency and accuracy in financial reporting, reflecting the importance of trust and reliability in client relationships. Additionally, 41.6% of respondents expressed concern about the exaggeration of expenses. While this percentage is lower than those concerned about the fair presentation of facts to increase profit, it still represents a notable portion of clients who are wary of the potential for expenses to be overstated inaccurately.

Such concerns may relate to the impact of inflated expenses on reported financial performance and overall business profitability.

The data indicates that clients are particularly concerned about the fair presentation of financial facts to increase profit, followed by concerns about the exaggeration of expenses. These findings underscore the importance of ethical financial reporting practices and the need for auditors to prioritize accuracy and transparency in their engagements with clients. Addressing these concerns is essential for maintaining client trust and fostering long-term relationships built on integrity and reliability.

**Table: 4. 28: Respondent’s response with regard to favor for audit opinion adjustment.**

Statement		Yes	No
There were circumstances/cases where managers or owners approached the auditors to adjust audit opinion (in their favor)	Frequency	4	8
	Percentage	33	77

Source: field survey 2024

The data provided reveals respondents' perceptions regarding instances where managers or owners approached auditors to adjust audit opinions in their favor.

The majority of respondents, comprising 77% of the total, indicated disagreement (No) with the statement. This suggests that a significant proportion of respondents do not believe that there were circumstances or cases where managers or owners approached auditors to adjust audit opinions in their favor. This viewpoint may reflect a general trust in the integrity and independence of auditors and a belief that such actions would be rare or uncommon.

Conversely, a minority of respondents, at 33%, agreed (Yes) with the statement. While this perspective exists, it is relatively small, indicating that only a fraction of respondents believe that there have been instances where managers or owners sought to influence audit opinions. This viewpoint may stem from concerns about potential conflicts of interest or undue pressure on auditors to modify their opinions to align with the interests of management or ownership.

The data suggests a divergence in perceptions among respondents regarding the prevalence of managers or owners approaching auditors to adjust audit opinions. While minorities of respondents believe that such circumstances or cases may occur, the majority do not share this belief. These findings underscore the importance of maintaining independence and

objectivity in the auditing profession to mitigate risks of undue influence on audit opinions and uphold the credibility and reliability of financial reporting.

**Table: 4. 29: Respondent’s response with regard to the termination of the contract**

Statement		Yes	No
You had to withdraw from your engagement owing to a perceived threat to your profession and independence.	Frequency	2	10
	Percentage	16	83

Source field survey 2024

The data provided offers insights into respondents' experiences regarding withdrawing from engagements due to perceived threats to their profession and independence.

The majority of respondents, comprising 83% of the total, indicated disagreement (No) with the statement. This suggests that a significant proportion of respondents did not withdraw from engagements due to perceived threats to their profession and independence. This viewpoint may reflect a belief among respondents that they were able to navigate potential threats and uphold their professional standards and independence throughout their engagements.

Conversely, a minority of respondents, at 16%, agreed (Yes) with the statement. While this perspective exists, it is relatively small; indicating that only a fraction of respondents felt compelled to withdraw from engagements due to perceived threats to their profession and independence. This viewpoint may stem from concerns about conflicts of interest, pressure from clients or management, or other factors that could compromise the integrity of the audit process.

The data suggests that the majority of respondents did not perceive significant threats to their profession and independence that necessitated withdrawal from engagements. However, a minority of respondents did experience such situations, highlighting the importance of maintaining vigilance and adherence to professional standards to mitigate risks to auditor independence and uphold the credibility of the auditing profession.

## **CHAPTER FIVE**

### **SUMMARY OF MAJOR FINDING, CONCLUSION AND RECOMMENDATION INTRODUCTION**

This final chapter serves as a comprehensive summary of the entire thesis. It begins by providing an overview of the thesis and its main conclusions. Subsequently, it concludes by offering recommendations for potential remedial actions.

#### **SUMMARY OF MAJOR FINDING**

The study was arrived at following findings which are helpful to give awareness about the study area:

Overall, the factors identified as the main reasons that hinder the professional responsibility of External audit firms include the absence of well-organized professional bodies in Ethiopia, which prevents auditors properly exercising their professional and legal responsibilities. Additionally, interviews and questionnaire responses revealed that the selection of auditors in different organizations is often based on family or friend relationships, leading to conflicts of interest. Auditors also tend to depend on their clients for financial and other interests, which compromises their independence.

Moreover, there are numerous instances where auditors provide opinions based on their clients' demands, typically favoring unqualified opinions. This practice is exacerbated when auditors perform both accounting and auditing services for the same client, resulting in violations of professional ethics. Finally, the study revealed that irregularities in laws and regulations further contribute to the challenges auditors face in maintaining their professional responsibilities.

#### **5.1 Conclusion**

Based on the findings, the following conclusions have been drawn:

- Preparation of financial statements is the responsibility of the management of the company
- The responsibility of auditors rests on examining the financial statements produced by the management and expressing an opinion based on findings.
- Besides, it has been identified through the study and in principle; auditors are legally liable for subsequently discovered misstatement audited financial statements.

- The study also identified auditors shall be civilly liable to the company and third parties for any fault in the exercise of their responsibilities which occasioned loss. As per the law of the country, an auditor who knowingly gives or confirms an untrue report concerning the position of a company or fails to inform the public prosecutor of an offense which he was known to have been committed shall be punished under Art. 438 or Art. 664 of the penal code as the case may be.
- But as it has been revealed through the study, there has been an occasion that auditors have been violating legal responsibilities.
- For instance, there is a circumstance that auditors are not signing a contract agreement with their clients for the purpose of audit work, compromising of auditor independence, and assigning less competent auditors.
- It was found out in the study that, the following were identified as the major constraints to private auditors in attempting to exercise their responsibility.
- There were occasions that clients demand unqualified opinion; there was low demand for audit service, and
- There was no strong professional association for auditors and also the educational level of auditors engaged in audit activities is another constraint that affects the audit profession in Ethiopia.

## 5.2 Recommendations

The following recommendations aim to support auditors in fulfilling their professional and legal obligations and providing decision-makers with pertinent audit reports:

- Government authorities establish robust associations tasked with overseeing the activities of private auditors and adjust audit fees based on experiences from other countries.
- Both audit firms and governmental entities monitor the competence of auditors engaged in audit activities to ensure effectiveness and compliance with professional standards.
- Organizations undergoing audits strive to employ professional accountants or provide training to existing staff to enhance awareness of the responsibilities associated with the audit profession and legal liabilities before conducting audit activities.
- The Ethiopian governments enact legislation stipulating the maximum duration that one audit firm can audit the same companies, thereby promoting rotation and preventing potential conflicts of interest.
- Government authorities take decisive measures against companies that deliberately overstate expenses in financial statements, as this practice can artificially reduce total profits and tax payments to the government, resulting in financial losses for the state.

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# APPENDIX I

Addis Ababa University

School Of Graduate Studies

Department of accounting and Finance

Survey questions on the Auditors Professional Responsibilities and legal liability with regard to Private Auditors in Ethiopia. The main purpose of this questionnaire is to gather information for the fulfillment of a study, which is made to assess the auditor's professional and legal responsibilities practice by private auditors and the consequence of violation of this responsibility in Ethiopia.

The questionnaires deals with the auditee organization view on private auditors professional responsibilities exercise as well as measures to be taken on illegal audit practices. Therefore, your assistance in responding to this questionnaire is indispensable.

This questionnaire is to be filled in by the management of sampled organizations or companies in Ethiopia, Addis Ababa. I would like to assure you that all the information given would be kept confidential. In advance I thank you very much for devoting your precious working time in filling this questionnaire. In tilling the questionnaire the following arc suggested

## Direction I

It is not necessary to write your name

You can circle the letter (s) your choice (s) to questions with alternative answers.

For the open- ended quest ions you may write your response in the space provided.

## Part-J Demographic Data

1. Age: \_\_\_\_\_
2. Sex:                    A. Male        B. Female
3. Marital status:        A. Married        B. single
4. Educational status:    A. Certificate (12+ 1)        B. Diploma (12+2)        C. Degree  
and above Others (please specify) \_\_\_\_\_
5. What is the full name of your organization?

6. Business type: A. Corporation B. Partnership C. Private limited company  
 D. Sole proprietorship E. Other \_\_\_\_\_

7. In which of the following sectors can your organization be categorized?

- A. Hotels and restaurants B. Agriculture, hunting and forestry

- C. Mining and quarrying D. Other \_\_\_\_\_

PART II: Instructions 2: Please tick (P) the level of agreement which you feel is the most appropriate using the scales ranging from 1 to 5 (Where 1 = Strongly Agree, 2 = Agree, 3 = Neutral, 4 = Strongly Disagree, and 5 = Disagree).

S/N	Statements	Strongly Agree	Agree	Neutral	Strongly disagree	Disagree
1	Auditors are independent from their clients in all matters					
2	Auditors have skill sand competency of in performing audit activity					
3	The auditors prepared an audit work plan, and mandatory supervision was provided by audit firms.					
4	Auditors exercise due professional care.					

S/N	Statements	Strongly Agree	Agree	Neutral	Strongly disagree	Disagree
<b>Part II</b> the internal control structure						
1	Private auditors in Ethiopia examine the internal control structure of an audit organization.					
2	Auditing standards are applied in the preparation of the financial statements, and auditors also follow that principle in examining audit activity.					
3	Auditors follow the materiality of information when disclosing it to the users of the report.					
4	Signing a contractual agreement is mandatory, outlining the audit scope, auditor qualifications, duration, management and auditor responsibilities, audit fees, and more.					
5	Auditors are responsible for contractual agreements made between the client and the auditor					
	Auditors who violate statutory responsibility are legally liable for both to their client and a third party					
	The management of client					

	organization is responsible for preparing financial statements.					
	Private auditors are legally liable for subsequent discovery of misstatement audited financial statements					
	The auditors are selected and assigned					

PART II: Instructions 2: Please tick (P) the level of agreement which you feel is the most appropriate using the scales ranging from 1 to 4 (Where 1 = friendly or family relationship, 2 = Advertisement on media, 3 = controlling unit, 4 = Based on recommendation).

Statement		friendly or family relationship	Advertisement on media	controlling unit	Based on recommendation
The auditors are selected and assigned					

Statement		For taxation	For creditors or external users	For auditing accounting book is mandatory
Purpose of auditing				

PART III: Instructions 2: Please tick (P) the level of agreement which you feel is the most appropriate using the scales ranging from YES to NO

Statement		Yes	No
Audit opinion			

PART III: Instructions 2: Please tick (P) the level of agreement which you feel is the most appropriate using the scales ranging from 1 to 5 (Where 1 = Strongly Agree, 2 = Agree, 3 = Neutral, 4 = Strongly Disagree, and 5 = Disagree).

S/N	Statements	Strongly Agree	Agree	Neutral	Strongly disagree	Disagree
1	Absence of a regulatory body to be the most serious challenge within the legislative environment followed by lack of professional responsibility					
2	The financial statements submitted to stakeholders are a fair presentation of facts of reporting entities					
3	The financial statements submitted to stakeholders are a fair presentation of facts of reporting entities					
4	One of the safeguards to protect against undue exposure to professional liability is verification of potential clients' compliance history and the nature of business they are engaged in, before taking a professional appointment.					

**THANK YOU!**