

**St. MARY'S UNIVERSITY**



**FACTORS AFFECTING AUDITORS INDEPENDENCE IN THE  
CONTEXT OF PRIVATE AUDIT FIRMS IN ADDISABABA**

**BY: - HAREGEWOIN G/HIWOT**

**JUNE 2023**

**ADDISABABA, ETHIOPIA**

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IN ACCOUNTING & FINANCE**

**ADVISOR: ANDINET ASMELASH (ASSIST. PROF.)**

**JUNE 2023**

**ADDIS ABABA,ETHIOPIA**

## Declaration

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Assist. Professor Andinet Asmelash. All Sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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Signature

**ST. MARY'S UNIVERSITY, ADDIS ABABA**

**JUNE, 2023**

## Endorsement

This thesis has been submitted to St. Mary's university school of Business: Graduate Program for examination with my approval as the university advisor.

Andinet Asmelash (Assist. Prof.)



Name

Signature

**St. Mary's University, Addis Ababa**

**JUNE, 2023**

**ST. MARY’S UNIVERSITY SCHOOL OF GRADUATE  
PROGRAM  
DEPARTMENT OF ACCOUNTING & FINANCE**

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**BY: HAREGEWOIN G/HIWOT**

**Approved By Board of Examiners**

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## Acronyms

**AQ:** Audit Quality

**AICPA:** American Institute of Certified public Accountants

**CPA:** Certified Public Accountants

**CPE:** Continuing Professional Education

**FAR:** Forening Auktoriserade Restorer

**GAAP:** Generally Accepted Accounting Principles

**GAAS:** Generally Accepted Auditing Standards

**GAO:** Government Accountability Office

**ISA:** International Auditing and Assurance Standards Board

**IESBA:** International Ethics Standards Board of Accountants

**IFAC:** International Auditing and Assurance Standard board

**ICAA:** Institute of Certifying Accountants and Auditors

**IAASB:** International Auditing and Assurance Standards Board

**NSE:** National Stock exchange of India ltd

**SPSS:** Statistical Package for social Science

**SOX:** Sarbanes Oxley SOX

**SOA:** Sarbanes-Oxley Act

## ***Abstract***

*This study examines factors affecting auditor's independence in the context of private audit firms in Addis Ababa. This study also aims in examining the effect of self-interest threats, self-review threats, advocacy threats, familiarity threats, intimidation threats and audit reputation on auditor independence. The data conducted had a close ended five point likert scale questionnaire. In order to achieve the desired outcome the study used explanatory research design. The study conducted used a non-probability convenience sampling technique for auditor. Data were collected using questionnaire; which was administered to 200 auditors in selected Audit firms in Addis Ababa. The data analysis was done using statistical package for Social Science version 20. Descriptive statistics including frequency tables and mean is used to present the results of the study by running a correlation test and regression analysis. The finding revealed that there are positive and significant relationships between self-interest threats, self-review threats, advocacy threats, familiarity threats, intimidation threats and audit reputation on auditor independence.*

**Key Words: Auditor Independence , Auditors threats**

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the study

Auditing is the gathering and assessment of informational evidence in order to ascertain and document the extent to which the information complies with predetermined standards. An experienced, unbiased person should conduct the audit (Arens, 2012).

According to ISA 200, the purpose of an audit is to increase the audience confidence in financial statements. This is done by the auditor issuing an audit opinion on whether an annual financial statements have been prepared in all material respects. Kaplan publishing UK (2015) in accordance with applicable financial reporting frameworks.

The Value of auditing depends heavily on the public's perception of the independence of auditors .The reason that many diverse users are willing to rely on CPA's report is their expectation of unbiased view point (Arens, 2012).

An audit includes procedures to obtain evidence about the amounts and disclosures in the financial statements and to assess the reasonableness of estimates made by management (KPMG, 2008). The quality of the audit report is a prerequisite for enhancing the credibility of financial statements with stakeholders.

Independence of mind reflects the auditor's state of mind that permits the audit to be performed whenever management interests are not in order with that of stakeholders, an organization contracts external auditor (Barzegar&Salehi, 2008). Agency theory states that an agency relationship exists when an agent is hired to act on behalf of a principal. As quoted by Hilda (2015), this relationship is built on the certainty that the agent will perform the duties entrusted to him as if the principal existed and acted alone.

Auditor independence refers to the independence of the auditors from the parties that have an interest in the financial statements of an entity. The auditors are expected to give an unbiased and honest professional opinion on the financial statements and hence their opinion should not

be influenced by any means. The need for independence arises because in many cases users of financial statements and other third parties do not have sufficient information or knowledge to understand what is contained in a company financial statement.

## **1.2 Statement of the problem**

According to AICPA (2006) audit independence as one's ability to act with integrity and exercise objectivity and professional skepticism.

Auditor independence refers to the impartiality and objectivity of an auditor in conducting an audit, free from conflict of interest and bias. It aims to increase public confidence in financial reporting by ensuring that the auditor's opinions and assessments are unbiased.

Independence is lost when the auditors have a personal relationship with clients of any size. There is a likelihood that the mental strength of the auditors was at stake such that the objectivity of their opinion may not be enough to ensure all assertions made by management represent a true and fair view of the state of affairs. .We generally believes that there is a close relationship between the auditor independence and threats that affect auditor's independence.

Independence is lost when the auditors have a personal relationship with clients of any size, which often arises when threats exist either individually or collectively. There is a likelihood that the mental strength of the auditors was at stake such that the objectivity of their opinion may not be enough to ensure all assertions made by management represent a true and fair view of the state of affairs. We think that these threats that impair auditor's independence could normally exist between auditors and their clients of any size.

## **1.3 Research Questions**

Based on the above observe problems and gap, the study try to raise the following research questions.

1. What are the factors that affect auditor independence?
2. How each factor affects auditor's independence?
3. To what extent threats to auditing affect auditor independence?

## **1.4 Objectives of the study**

### **1.4.1 General Objective**

The general objective of this study is to evaluate factors affecting auditor's independence in the context of private audit firms in Addis Ababa.

### **1.4.2 Specific Objectives**

- ◆ To identify factors affecting auditors independence
- ◆ To assess how these factors affect auditors independence
- ◆ To evaluate the effect of each factor on auditors independence

## **1.5 Significance of the study**

Quality audit financial statement provide confidence to the users of financial information in making economic decision such as shareholders who may decide whether to put in more capital or making drawing. This study was provides a clear picture to the corporation and individual investors whether the duration of an auditor with the client can affect the quality of auditor's independence. The researcher believed that this study will make a number of contributions towards other researchers as a source of reference and as a stepping stone for those who want to provide further research.

## **1.6 Scope of the study**

It is important to define the boundaries of this study such that the readers aware of the direction to which this study is head. Hence, the searcher considers from the perspectives of auditors view for this study. The focus of this paper is on factors affecting auditor's independence in the context of private audit firms in Addis Ababa

## **Definitions of Terms**

**Auditing:** Auditing is a systematic process of obtaining an objectively obtaining evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results



to interested users (American Accounting Association, 1973).

**Auditor:** An auditor is an approved or authorized accountant with the capacity to carry out audit, have an education and experience required for the audit business, have passed the examination of professional competence as an approved or authorized accountant set by supervisory Board of Public accountants or Supervisory Board of Authorized Accountants.

**Objectivity:** “A professional accountant should not allow bias, conflict of interest, or undue influence of others to override professional and business judgmental” (Eilifsen,2006).

## **1.7 Organization of the study**

The study was organized in to five chapters. The first chapter was presented the introduction part consisting of the background of the study, statement of the problem, objective of the research, scope of the study and organization of the study. The second chapter was discussed related literature review of the study. In the third chapter, the study was presented research design and methodology. In the fourth chapter the study was presented analysis and interprets the data and in the fifth chapter major findings and conclusions and recommendations was presented.

## **CHAPTER TWO**

### **REVIEW OF RELATED LITERATURE**

#### **2.1. Introduction**

#### **2.2. Theoretical Literature Review**

##### **2.2.1. Audit**

Audit refers to an activity to address information asymmetry and the gap between different parties and an organization. It also plays a very crucial role in reducing agency costs, as well as increasing shareholders and third parties confidence to the reliability of the financial information provided by the financial statements. (Watts and Zimmerman 1983). Furthermore , it performs the function of administrating appropriate confidence towards the credibility and dependability of an organizations financial statements among the stakeholders (Gipper, Leuz and maffett, 2015). To achieve these objectives, independence of the auditor is key.

In short an audit could enhance the accountability, transparency, equity and integrity in the activities of an organization (Masood and Afzal 2016)

##### **2.2.2. Audit quality**

Stakeholders, investors, regulators and society, in general may have different views about audit quality. This will affect the type of indicators that may be used to assess audit quality. The auditor may define it as completing all requirements of the audit process, The user of reports may define it as discover of the material misstatements. Regulators evaluate the external audit quality as to be identical with professional standards. Hence, different definitions led to different measurements (Knechel, 2012).

There are definitions of audit quality. Despite continuous studies, there is no any consensus about which definitions or measure is the most popular and the various disclosures and frameworks that exist are incomplete (Knechel, 2012; Defond& Zhang, 2013).

DeAngelo(1981) defined audit quality as “The Probability that the auditor will discover a

breach and he will report this breach”. Auditing is a socially constructed activity, thus the meaning of audit quality is socially constructed and is influenced by economic and societal contexts (Sulaiman, 2011).

Audit quality considered as the heart of the audit process, and the demand for auditing, particularly with respect to audit quality. Audit quality is very important for all parties; due to the weakness of audit quality is the leading reason for audit failures. After the cases of audit failures and financial scandals, standard setters and regulators have attempted to promote audit quality.

The importance of audit quality arises from its effect on the reliability and credibility of financial statements and the auditor’s opinion could be misleading if the external auditor perform a weak work, and this will affect the decisions of stakeholders and users. In this disclosure, we believe that the audit quality is very important to protect the financial interests of the stakeholders, investors and other parties by enhancing the reliability and credibility of financial statements (Sulaiman, 2011; Memis&Cetenak, 2012).

Audit quality has been the focus of empirical and theoretical audit in research for the last years. Even though a plenty of studies investigate the audit quality especially in the western countries, there is a lack of empirical evidence from the developing countries context (Kitata, 2016). Very few studies had been conducted in developing countries. Furthermore, prior studies have documented mixed results on the linkage between audit quality and its proxy. Thus, the research question is open for new and through evidence to uncovering new insights.

The researcher needs to obtain better and new information to understanding audit quality from the regulators, auditors, clients, firms or other sources. With such information, we can continue the scholarly quest for a better understanding of audit quality (Knechel, 2012).

There are many external and internal factors that may affect the level of external audit quality. This section will introduce the most popular factors according to the prior literature. Some of this factors such as input factors (audit team behavior, expertise and audit procedure), output factors (influence of investors and stakeholders and legislative factors) and the interaction between different key actors. All of these factors can be an example on this influence (Nhme, 2013).

### **2.2.3. Auditor Independence**

Appah(2011) define auditor independence as an attitude of the mind based on integrity and an objective approach to work. He maintained that an auditor must at all times, perform his work objectively and impartially and free from influence by any consideration which might appear to be in conflict with this requirement. Appah, (2011) also noted that independence in auditing means having a position to take an unbiased view point in the performance of audit test , analysis of results and attestation in the audit report.

According to Smith (2011), auditor independence is the ability of a person conducting an audit do so autonomously and with integrity. Auditors must be able to review material objectively and come up with a neutral, accurate and honest report on the outcome of their investigations. When auditors lack this objectivity, it can compromise the value of the audit and may expose people to risks.

As per Mahadi, (2009), the concept of auditor independence changed during the late 19<sup>th</sup> and early 20<sup>th</sup> centuries. Because there was a large shift from capital coming from some sources to capital deriving primarily from domestic sources, noted economic sectors means articulated this change that large corporations were based on the separation of ownerships from management, which they also emphasized the growing importance and role of accounting and auditing. However the concept of auditor independence has proved difficult to define precisely even if representative definitions are presented by different authors as follows:

#### **2.2.3.1. Independence threats and Safeguards**

Eileen. (2006) defines threats to auditor independence as pressures and other factors that impair or are perceived to impair an auditors objectivity. Threat can either have the likelihood of occurring or not occurring in the audit process and the threats can be significant individually or in combination. If this threats crop up in any engagement services, then there is an issue of independent risk. Independent risk is determined by the likelihood that there will be a compromise or appear to compromise the reliability of the investors and other users of the audit report Eilifsen (2006).This means that there is need to uphold the auditor's independence consideration their very vital role in any business set up. This could be possible by

implementing or putting in place safeguards that will completely eliminate or reduce the threats to a minimal acceptable level. Safeguards to auditor independence are controls that mitigate the effects of the threat.

The aggregate risk arising from different threats must be assessed acceptable to independence risk as their effects may be cumulative. The level of the independence risk arising from different activities, relationship and circumstances will largely depend on the views of well knowledgeable investors as well as other users of financial statements Eilifsen, (2006). The independence risk can be determined if a vivid assessment of the significance of the threats and the effectiveness of the available safeguards are undertaken by the auditors Eilifsen, (2006). There are two things that must be done if the independence risk is unacceptable, take actions to reduce the threats to an acceptable level, or withdraw the partner or audit firm from the engagement.

#### **2.2.3.2. Categories of threats to independence**

Eilifsen, (2006) Hayes, (2004) and IFAC Handbook on international auditing, assurance and ethics (2008) identify five categories of Threats: The following sub sections below discuss and give examples on each of the above outlined threats.

- **Self-Interest Threat**

This occurs when the auditors favor or is perceived to favor their own self interest over the interest to perform an unbiased audit Eilifsen, (2006). This may arise from auditor's financial emotional or other personal interests in the clients. These threats occur when the auditor has material or non material interests with the client. These treats have effect on the auditor's independence. When the auditor offers a customer non-auditing services he should weigh the advantages and risks.

The biggest change to the auditors' independence is the amount of fees. In the beginning of his work, the new auditor accepts to be paid modest fees gradually raising them Schmidt, (2012)

- **Self-review threats**

This happened when there is a difficulty to evaluate without bias the auditor's work or that of

their firm Eilifsen, (2006). This may emanate from the auditor or a member of the audit team having a direct or indirect influence on the subject matter of the audit (in particular director or officer) in a position to exert significant influence over the subject matter of the assurance engagement. Examples include: The discovery of a significant error during a re-evaluation of the work of the professional accountant in public practice. Reporting on the operation of financial systems after being involved in their design and implementation. On performing service for the client if it directly affects the subject matter of the assurance engagements (Eilifsen, 2006; Hayes, 2004 and IFAC Handbook, 2008).

These threats arise when the auditor accepts to audit tasks that he contributed in achieving and a previous opinion was issued on them. They also include the auditor or his assistance become a worker at the company of the client, and in a position that helps him to influence the audit process significantly, or his assistant prepare a basic data which is used in preparing the financial statements or in the auditing function (ICAIW).

### **Safeguarding against self-review threat**

1. Ensuring the accounting service is not performed by a member of the audit team
2. Involving an additional appropriately qualified individual to review the work done or otherwise advise as necessary.
3. This could be someone from within the firm, who is not involved in the audit team, or someone from outside the firm.
4. Discussing independence issues with the board of directors or audit committee.

Policies and procedures to ensure members of the audit team do not make or assume responsibility for management decisions for the audit client.

#### **▪ Advocacy threats**

This is when the auditors act in bias when advocating for or against the client. This is the auditors subordinate their judgment to that of the client. These threats arise when the auditor supports the client in his practices and in his views.

Auditors who represent the client run the risk of jeopardizing their independence due to the possibility of advocacy. The act of doing so often poses little threat by itself. However, this risk

exists whenever auditors act in a way that could be interpreted as advocating for their clients, such as when they publicly support their clients or otherwise act as advocates. This risk may also be posed by the relationship between a client and the auditors.

Similar safety precautions are taken against the threat of advocacy and the risk of familiarity. By dividing their teams into distinct task-specific groups, auditors may avoid this difficulty. Auditors may be required to decide between maintaining existing audit contracts and representing clients.

- **Familiarity threats**

This may occur when because of a closer relationship; a chartered accountant becomes too sympathetic to interests of others. An auditor may work with clients for a long time, this assist in increasing the auditors knowledge about the clients activities,. The length period of service affects the independence of the auditor and changing him will raise the cost and reduce the auditors experience (Titus, 2014).

**Familiarity threat also occurred due to the following reasons:**

- A member of the engagement team having a close or immediate family relationship with a director or officer of the client
- Member of the engagement team having a close or immediate family relationship with an employee of the client who is in a position to exert direct and significant influence over the subject matter of the engagement
- A former partner of the firm being a director or officer of the client or an employee in a position to exert direct and significant influence over the subject matter of the engagement
- Accepting gifts or preferential treatment from a client unless the value is clearly insignificant
- Long association of senior personnel with the assurance client

**Safeguards**

- Assigning an assurance team that is sufficient experience in relation to the individual who has

joined the assurance client

- Involve an additional chartered accountant who was not a member of the assurance team to review the work or advice as necessary
- Quality control review of the assurance engagement
- Ensuring that the individual does not continue to participate or appear to participate in the firm's business or professional activity

- **Intimidation threats**

This may occur when a chartered accountant may be deterred from action objectively by threats actual or perceived.

Example include: threatened with litigation , threatened with dismissal or replacement over a disagreement about an application for an accounting principle or policy of the client pressured to unjustly reduce the extent of work to be done in order to reduce fees (Eilifsen, 2006; Hayeser, 2004 and IFAC handbook, 2008).

### **Safeguards**

- Consider the appropriateness or necessity of modifying the assurance plan for the assurance engagement
- Assigning an assurance team that is of sufficient experience in relation to the individual who has joined the assurance client.
- Involve in additional chartered accountant who was not a member of the assurance team to review the work
- Quality control review of the assurance engagement
- Ensuring that the individual concerned is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed predetermined arrangements



#### **2.2.4. Safeguard created by the profession, legislation or regulation**

These are safeguards present in ethical or professional standards or laws as well as acts or rules put in place by professional, legislative and regulatory bodies respectively to detect threats and preserve the a auditors independence. These may include Professional accounting and auditing ethical standards. Professional rules and legislation governing independence requirements of firms. Educational training and experience requirements before becoming a certified practitioner of the profession and peer review of quality control Hayes, (2004).

##### **2.2.4.1. Safeguard within the auditor and the audit firm's own system and procedures**

These are firm wide safeguards implemented by the auditor which guides the procedure of undertaking task within the audit firms system. Examples of such include leadership of the firm constantly stressing on the importance of independence. Policies and procedures that ensure and assure that quality control of engagements. Appointing a senior member to oversee the adequate functioning of the safeguard system. Policies and procedures that monitor and manage the reliance of revenue received from a single client, Hayes et al, (2004).

##### **2.2.4.2. Safeguard created and maintained within the client**

These are safeguards created and maintained within a particular client as the threats that may be involved may not be the same from client to client. An effective corporate governance structure like the audit committee in the client firm that provides appropriate oversight and communications regarding the firm's exercises (Eilifsen, 2006, Hayes, 2004 and IAC Handbook, 2008).

Being either a short or extended tenured auditor, the professional auditing bodies require the auditing firms to have the necessary safeguards in place to shield their independence. The auditor safeguards should be such that they can easily detect, prevent and correct any threats that can arise to threaten their independence. Auditors who do have extended audit tenures must have to adapt their safeguards to the changing times. It is on very rare cases that the client's businesses do not change over time, and as these changes occur, there are a lot of challenges and threats that appear along with them. Auditors who do have extended tenures stand a greater risk of losing their independence if their safeguards remain the same as the business landscape of

their client changes. This is because some of the safeguards could simply be out of place to face the new threats that surface.

The threats of auditor independence do not come from space. These threats emerge mostly from the actions of the auditor. It is important to identify some of the two most important sources we think that help protect these threats.

## **2.3. Empirical Review**

### **2.3.1. Auditor Independence**

According to Independence standard board (2000) auditors' independence is the freedom from those pressures and other variables that compromise an auditors capacity to make unbiased audit choices can reasonably be anticipated to compromise. Opinion express by an independent auditors boosts the confidence of investors in the reporting system, and further translate to an improved in capital markets efficiency (sofian and Saat, 2013).

Ns on quality audit by Lim and Tan (2010) revealed that quality audit was associated to audit moderated by auditor's specialization and audit fees and analyzed this relation using ordinary least square (OLS) regression. In another study by McNichols, (2012), accrual quality model was used to measure quality audit and it was found that companies audited by specialists in their industry had relatively higher quality audit. However, this relationship was moderated by auditor's dependence on audit fees from clients.

Based on Journal of International business research ; Vol, 8; 2015 the study conducted aiming at identifying the effect of threats on the auditor's independence , the researcher found that threats on the auditors (Self interest threats, self review threats, advocacy threats, familiarity threat and intimidation threat) affect the auditors independence. The study recommends that auditors should know the effects of threats on auditors independence, and should abide with the rules of professional behavior and exercise the suitable defensive procedures against these threats.

### **2.3.2. Auditor Reputation**

According to De Angelo (2011), users of financial statements use auditor reputation to infer unobserved quality audit based on the provided audit reports. A audit firm builds its reputation

over time by producing quality work. To maintain its reputation, total commitment is required from each member of the team since a well-earned reputation should conform to the report produced in each audit report.

Klen and Leffler (2011) formulated a model for endogenous quality to study audit firm reputation versus audit quality. They reported that a firm's reputation or brand was a key characteristic that improved audit quality. High reputation firms produced high quality audit because of higher levels of available resources and greater degree of personnel training and expertise. Similarly reputation costs provide the incentive to convey higher audit quality.

### **2.3.3. Auditor Independence**

According to Sweeney (2014), when an auditor lacks independence then chances of being perceived as not being objective are very high. This occurs if an audit firm becomes too involved with its client and further issues an audit opinion that may deceive and manipulate investors. According to Defond, (2012) and in a similar study by Carey and Simnett (2006), they purported those auditors that auditors must objectively evaluate the client's performance and withstand client pressure to issue a clean opinion. Hence, independence plays a pivotal role to maintain audit quality.

DeAngelo, (2011) in her study concluded that to enhance that independence of the auditor, audit committee should conduct meetings with the external auditor in absence of the company's management and senior committee members.

In Sweden, a research on the effects of threats on auditor independence was undertaken by Etienne in 2010. The study used a sample of 1,250 auditors through email in order to explore the results, and out of this, 265 replies were obtained, implying a response rate of 21.2% even though 10-15% was expected for the survey. The real response rate is still quite low, though. This study's research question is categorical rather than objective: Does the relationship between audit threats and auditor independence have the potential to compromise or not compromise auditor independence? The study's questioner utilized liker scales, which are an appropriate tool for gauging respondents' sentiments. The responses gotten were analyzed using a quantitative method, paired samples t-test in SPSS. Though some of the threats may increase with lengthy audit time, leading the study to draw the conclusion that threats to auditors can be a source for

to auditor independence.

#### **2.3.4. Auditor Professional Competence and Due Care**

Sundgren, (2015) argued that certified auditors provided higher level of assurance than non certified auditors. He noted that non certified auditors are less probable to customize their audit reports compared to their counterparts and that at minimum quality audit differs between the two. This implied that certified auditors provide higher level of assurance than non –certified auditors. An auditor has to maintain professional proficiency through continuing professional education (CPE). Practical work provides a key learning point for an individual.

Manita and Elommal (2010) constructed a new stream of research that focused on auditor professionalism and competence which is driven by an entire audit process as per IAASB (2011). The IAASB describes audit quality (AQ), as the process that concerns such matters as the soundness of the audit methodology, effectiveness of audit tools used, availability of adequate technical support that are all geared towards supporting execution of quality audit.

#### **2.3.5. Audit Quality**

According to Titman and truman, (2016), auditors need to provide high quality audit services. Palmrose, (2011) was also a proponent to the study and described audit report as quality when there is no misstatement in financial reports. The same view was laid forth by Epstein & Geiger (2014) that the perceived quality audit for audited financial statement is higher since audited financial statement provides absolute assurance to users that the financial statement contains no material errors and misstatement.

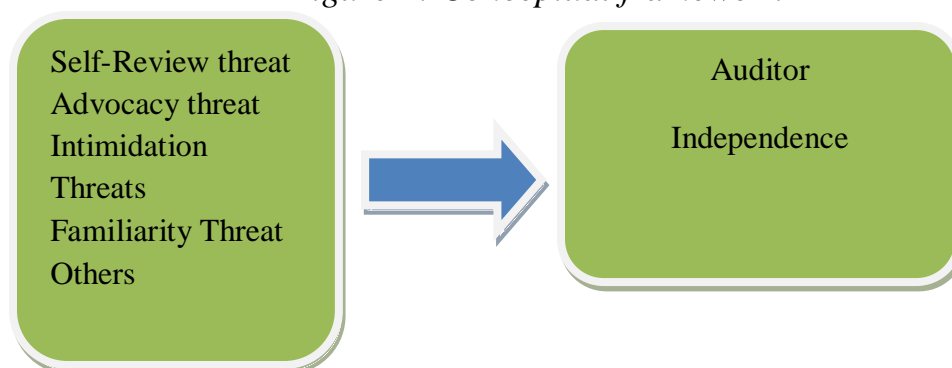
Schuer, (2012) added that when audit services provided are of higher quality, there is a high possibility that the financial statements are précised and correct reflecting the financial position and results of operations of the entity being audited.

### **2.4. Conceptual Framework**

Auditors independence can be affected by different factors. As mentioned in earlier chapters, it may be possible that self review threat, advocacy threat, intimidation threat, familiarity threat and others become a source of threats to auditor independence. The threats may either impair

the auditor independence individually or collectively based on the circumstances in which the auditor find themselves. But the bottom line is that these threats when they emerge, they affect the auditors function through the audits as the auditors may cease to be objective since their independence is impaired. To be able to add value to the audits, auditors should be free from any of the threats listed above. As mentioned earlier, just having safeguards will not by any means protect the auditor independence. But threats to auditing could impair auditor's independence individually or collectively.

*Figure 1: Conceptual framework*



## **2.5. Summary and Knowledge Gap**

This study has reviewed studies from different scholars covering the five study variables (self-review, self-interest, advocacy, intimidation and familiarity threats) and other determinants that affect auditor independence (Non-Audit Services (NAS)).

Researchers like Beattie (1999) indicate that economic dependence on the client by the auditor is seen to be a serious threat to auditor independence.

That notwithstanding, the findings of Canning and Gwilliam (1999) which found that there is a perceived reduction in auditor independence when NAS are provided to the audit clients by audit personnel. Though NAS is limited only to advising and that of Canning and Gwilliam (1999) consider other NAS as well as consulting services, however, advising services also constituted an integral part of NAS in the study of Canning and Gwilliam (1999). Therefore, the findings to that of Canning and Gwilliam (1999) does not by any chance subject the relationship of both studies to any misjudgments. This because the study Canning and Gwilliam (1999)

considered NAS and auditor independence, with auditor independence been the center of attraction and this enables us to easily relate.

As identified by Eilifsen et al. (2006, p.580), acting as an advocate for litigation cases or disputes on behalf of the client, and selling or underwriting shares of a client threatens the auditor independence. The fact that intimidation threats could be seen in different ways is consistent with the findings in Beattie et al. (1999) where the similar situations also had notably higher standard deviation than other factors.

Nur et al. (2005) carried out a study on the causes of losing auditors independence. The scope of the study is very wide since the presence of many factors for the loss of auditor independence. Another study by Philmore et al. (2006) reveals that the study was conducted with the help of quantitative methods only and the sample was selected from auditors and users of audited financial users

As to the knowledge of the researcher, it can be concluded that although there have been studies on Factors Affecting Auditors Independence in the context of private audit firms in Addis Ababa. The researcher believes that this research paper could be used as an additional input for others who conduct further studies.

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

#### **3.1. Introduction**

This chapter presented research design and technique, data type and source, total population and sampling design technique, method of data collection and data processing and analysis and ethical considerations. Griffin, (2010) describe a research methodology as a part that must explain technical procedures in a manner appropriate for the audience.

#### **3.2. Description of the Study Area**

The independence of any auditor is a very important aspect in their professional career as this independence upholds the stature of the profession. The general public, particularly the shareholders, put their trust in the functions of the auditors and expect them to truly and impartially express an opinion as to the fairness of the financial statements presented by the stewards. Therefore, the auditors cannot adequately perform this function if they are not seen as independent from management. This is to say that they must undertake their work independently from management and may not have an overly cordial relationship with management. The issue at stake now is whether their factors to auditing impairs their independence; This was in turn made those who depend on the financial statements to consider them unreliable and it forces the researcher to conduct this study.

#### **3.3. Research design and Approach**

A research design is simply the framework or plan for a study that is used as a guide in collecting and analyzing the data. It is a blueprint that is followed in completing a study. Research design is the blueprint for collection measurement and analysis of data. Actually it is a map that is usually developed to guide the research.

The primary aim of this study is to investigate factors affecting auditor's independence in the context of private audit firms in Addis Ababa. To achieve this objective, explanatory type of research design is used. Explanatory research design enables give insight about a given subject

and relates it to the existing knowledge (Cooper and Shindler, 2013).

This study was applied quantitative and qualitative method approach was one in which data was collected and analyzed by researcher. By applying the quantitative method the researcher was ensured the strength of the findings towards being more objective to the entire population (Creswell, 2003).

### **3.4. Population**

In research methods population is the entire aggregation of items from which sample could be drawn. In this study the targeted populations was selected private audit firms licensed and registered in Addis Ababa.

### **3.4. Sampling technique**

According to Japheth (2014), sampling technique is defined as selecting the require sample size in a manner so that the sample is representative of the study population. Sampling can be used to make inference about population or to make generalization in relation to existing theory. In essence, this depends on choice of sampling technique. Sampling technique can be classified in to two main groups, probability and non-probability sampling. This study was used convenience sampling which is one of non-probability sampling techniques. The researcher uses Convenience sampling for the sake of time management and cost minimization and relies on data collection from population members who are conveniently available to participate in study. In other words this sampling involve getting participants wherever you can find them and typically wherever is convenient. In convenience sampling no inclusion criteria identified prior to the selection of subjects. All subjects are invited to participate (Saunders, MlewisP& Thornhill, 2012).

### **3.5. Sample size**

According to Zamboni (2017) sample size is an important concept in statistics, and refer to the number of individual pieces of data collect in a survey. Based on convenience sampling technique samples was collected from population. Questioners were distributed for each selected audit firm. The questionnaire was answered by principal partners and or employed



auditors. A statistic's sample size is important in determining the accuracy and reliability of a survey's findings. The study selects two hundred (200) auditors.

### **3.6. Source of data and data collection tools**

The study was used both primary and secondary source of data. The primary data contains opinions of the respondents on various aspects. Self-administrating questioners was developed based on previous empirical literature. The close ended questions also was used ranging from 1(strongly disagree) to 5 (strongly agree). The questioner was beginning with an introductory statement which was specifying the purpose of the research as purely academic purpose. Secondary data was collected from certified copies of financial statements and reports, business magazines, websites and company manuals.

### **3.7. Data Analysis Methods**

In this study, analysis of data aim to identify factors affecting auditor independence. The study was used descriptive and infractional statistics such as mean,standard deviation for descriptive statistics infractional statistics for correlation and regression. Then the data was measured using a statistical software SPSS and was presented inform of narrations and summarized tables.

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

#### **Validity**

Validity is the extent to which differences found with a measuring tool reflect true differences among respondents being tested. The purpose of validity in the study has been to seek relevant evidence that confirms the answers found with the measurement device which is the nature of the problem.

Validity was achieved by pre-testing the instrument to use to identify and change any ambiguous or offensive questions and technique as emphasized. Copies of the questionnaire were distributed to thirty respondents as a pilot test. This was done to find out whether the develop instruments measures what it was meant to measure and also to check the clarity, length, structure and wording of the questions. This test also helped the researcher to get valuable comments to modify some questions.

## Reliability

The reliability of the scale which is how the collects data is free from random error was check by Cronbach's alpha. Cronbach's alpha is a statistic. It is generally use as a measure of internal consistency or reliability of a psychometric instrument. In other words, it measures how well a set of variables or items measures a single, one-dimensional latent aspect of individuals. In order to be reliable, using SPSS result, the Cronbach's alpha should exceed the threshold of .70. This indicates that there was a high degree of internal consistency amongst the test items. (Streiner, Norman, 1989)

*Table 1 Reliability Statistics test*

Reliability Statistics	
Cronbach's Alpha	N of Items
.776	30

This indicates that there was a high degree of internal consistency among the test items

### 3.9. Ethical Considerations

The study was conducted by considering ethical responsibility. It was includes providing information to the respondents about the purpose of the study and the use of the information as well. Information gathering was held in strict confidentiality by the researcher Respondents' anonymity is kept so that participants will feel free and safe to express their ideas. The researcher was also notifying that their organization in the study is voluntary, that they have the freedom to get information easily at any time.

## CHAPTER FOUR

### DATA PRESENTATION, ANALYSIS AND INTERPRETATION

This chapter deals with data presentation, interpretation and analysis of the collected data through questioner. Descriptive statistics like frequencies, percentage and mean were used to analyze the data moreover Pearson correlation also used to show the relationship between dependent and independent variables. Finally regression analysis was deployed to show the effect of independent variables over the dependent. The findings from the questionnaires were analyzed by using SPSS (version 20).The results from the study are presented in the form of mean and standard deviation table.

As stated in the previous chapter of this paper, questioner were designed and distributed to a total of 200 workers. Accordingly, 163 questionnaires were appropriately filled and returned which give 83% return rate that is assumed to be suitable for further analysis.

The first part of the questionnaire consists of seven items about the demographic information of the respondents. The second part of the questionnaire contained four general questions about general view. The third part of the questionnaire is the main part of the thesis with “liker Scale “.

#### 4.1. Demographic Profile of the Respondents

The demographic characteristics of the respondents was analyzed and given as below. This was done mainly to determine the suitability of the respondents to provide the Needed information for the validity of the study

*Table 2Gender*

Item	Frequency	Percent
gender male	128	78.5
gender female	35	21.5
Total	163	100.0

Source; (own survey, 2023)

As shown in the table 2, from the total respondents for this research 78.5% are male and

the remaining 21.5% are female. According to the AABE website female auditors obtained practicing certificate are not more than 11% of the entire auditor in Ethiopia. Therefore the huge gap on gender perspective on this research is not surprise.

*Table 3 Demographic Profile*

Item		Frequency	Percent
Age	20-30 year's	60	39.2
	31-40 years	70	42.2
	41-50 years	33	21.6
	Total	163	100.0
Education level	Bachelor's Degree	115	70.6
	Master's degree	48	31.4
	Total	163	100.0
Years of work experience as auditor	below 5 years	27	17.6
	6-10 years	72	47.1
	Above 11 years	64	39.3
	Total	163	100.0

Source; (own survey, 2023)

The age distribution of respondent auditors shows that a majority (42.2%) of the auditors were in age group of 31-40 years, 21.6% in the age group of 41- 50 years, and 39.2% in age group of 20- 30 years. The age category in which high majority participants fell into is active and energetic and hence would provide valuable information. The service years of auditors range from less than 5 years (17.6%), 6 to 10 years (47.1%), above 11 years (39.3%), from the above table most of the auditors participated in the study (70.6%) were holders of bachelor's degree in business related filed, (31.4%) who had a master's degree, this implies that majority of the respondents had bachelor's degree. This level of education was the requirement for the auditors to work effectively without interference that is they could work independently the audit profession.

## 4.2. Descriptive Statistics Analysis

In this part, descriptive statistics, in the form of mean and standard deviation, was presented to illustrate the level of agreement of the respondents with their implications of the impacts of extended audit tenure on auditor's independence. The responses of the respondents for the variables indicated below were measured on five point Likert scale making interpretation of the results of mean and standard deviation the scales were reassigned as follows to make the interpretation easy and clear. Using a 5 point likert scale where 1-1.499 = not at all, 1.500- 2.499 = low extent, 2.500- 3.499= moderate extent, 3.500-4.499 = great extent and 4.500- 5.000 = very great extent,(Mohamed Dawud 2017).

### 4.2.1 Audit fee

Audit fees refers to the degree of economic dependence an audit firm has on a particular client in terms of audit fees. Economic dependence is highly influenced when an auditor performs other consultancy services to client such as taxation, accounting, system design, valuation, recruiting and trainings on addition to auditing thereby increasing risk on quality audit caused by financial reliance of auditing firm on a client. Fear of losing additional income causes an auditor to fail to contradict management even in genuine cases. Further being too familiar with management may cause and auditor to lose his or her professional skepticism (Holye, 2015).

Table 4 Audit fee

	Mean	Std. Deviation
the auditors independence is affected when the clients fees represent more than 15% of the auditors revenue for new audit firms	3.9608	.48507
the auditors independence is affected when the clients fees represent more than 15% of the auditors revenue for permanent audit firm	3.5294	.60761
Competition between audit firms on audit fee will affect auditors independence	3.9412	.57623
Large size of audit fees is normally associated with a higher risk of losing the auditor's independence	2.6275	.79374
Valid N (listwise)		

According to the table above, majority of the respondents agreed to the auditors independence is affected when the clients fees represent more than 15% of the auditors revenue for new audit firm. It indicated that a mean response of 3.9, and (SD=.48) this was also reflected in the descriptive analysis were most of respondents are agreed. So the result show that the auditor's independence is affected when the client's fees represent more than 15% of the auditors revenue for permanent audit firms.

The study further discovered that the auditors independence is affected when the clients fees represent more than 15% of the auditors revenue when hiring new audit firms. It indicated that a mean response of 3.5, and (SD=.60) this was also reflected in the descriptive analysis were most of respondents are agreed. So the result show that the auditor's independence is affected when the client's fees represent more than 15% of the auditor's revenue for permanent audit firms.

The study revealed that Competition between audit firms on audit fee will affect auditor's independence. It indicated that a mean response of 3.9, and (SD=.57) this was also reflected in the descriptive analysis were most of respondents are agreed. Therefore we can conclude Competition between audit firms on audit fee will affect auditor's independence.

The study regarding large size of audit fees is normally associated with a higher risk of losing the auditor's independence. As indicated by a mean response of 2.62 and .793 standard deviation. This was also revealed in the descriptive analysis which indicated that most of respondents are disagreed. Therefore we can conclude large size of audit fees is not associated with a higher risk of losing the auditor's independence.

In general, above questions were distributed to investigate the auditors independence affected when the clients fees represent more than 15% of the auditors revenue .

#### **4.2.2 Non Audit Services**

Auditors are attracted by the economic benefits to provide non-audit services to their audit clients as non-audit services are perceived to be more profitable (Tepalagul and Lin, 2015). Causholli. (2015) argued that auditors' provision of non-audit services to their clients will create

economic ties between them. In turn, this could decrease auditor's independence.

*Table 5 Non Audit Services*

	Mean	Std. Deviation
The auditor also provides non audit services to the client. The value of the non-audit fees is equal to or greater than 100% of the audit fees.	3.6667	.47295
The auditor also provides non-audit services to the client. The value of the non-audit fees is up to or equal to 25% of the audit fees.	3.3333	.47295
non-audit related services can create an economic bond between the auditors and the client that can compromise auditor independence	4.2353	.42558
Valid N (listwise)		

This was also revealed in the descriptive analysis which indicated that most of respondents are moderate agreed. so the result show that an auditor has had a client for less than 1 year; the auditor also provides non audit services to the client. The value of the non-audit fees is equal to or greater than 100% of the audit fees. As indicated by a mean response of 3.66 and .472 standard deviation.

The study further discovered that an auditor has had a client in less than 1 year; the auditor also provides non-audit services to the client. The value of the non-audit fees is up to or equal to 25% of the audit fees. It indicated that a mean response of 3.33, and (SD=.472) this was also reflected in the descriptive analysis were most of respondents are moderately agreed.

According to the table above, majority of the respondents strongly agreed to non-audit related services can create an economic bond between the auditors and the client that can compromise auditor independence. It indicated that a mean response of 4.23, and (SD=.425) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude non-audit related services can create an economic bond between the auditors and the client that can compromise auditor independence.

### 4.2.3 Self-interest threats

These threats occur when the auditor has material or non-material interests with the client.

These threats have effect on the auditor's independence.

*Table 6 Self-interest threats*

	Mean	Std. Deviation
the auditors independence is affected when a material interests directly and indirectly with the client	4.1569	.36487
The auditor's independence is affected when custom to lend client or borrow from him.	4.2353	.42558
The auditor's independence is affected when there is a probability to become an officer in the client enterprise	4.0392	.52418
The auditor's independence is affected when the auditor's concern about the possibility of losing the engagement	4.3922	.48983
Valid N (listwise)		

According to the table above, majority of the respondents strongly agreed to the auditors independence is affected when a material interests directly and indirectly with the client. It indicated that a mean response of 4.15, and (SD=.364) this was also reflected in the descriptive analysis were most of respondents are strongly agreed Therefore we can conclude that auditors independence is affected when a material interests directly and indirectly with the client.

The study revealed that the auditor's independence is affected when custom to lend client or borrow from them. It indicated that a mean response of 4.23, and (SD=.425) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude that auditor's independence is affected when custom to lend client or borrow from them.

The study further discovered that the auditor's independence is affected when there is a probability to become an officer in the client enterprise. It indicated that a mean response of 4.23, and (SD=.425) this was also reflected in the descriptive analysis were most of respondents are agreed. So the result show that the auditor's independence is affected when there is a probability to become an officer in the client enterprise.



The study regarding of the auditor’s independence is affected when the auditor’s concern about the possibility of losing the engagement. It indicated that a mean response of 4.23, and (SD=.425) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. So the result show that the auditor’s independence is affected when the auditor’s concern about the possibility of losing the engagement.

#### 4.2.4 Self-review threats

These threats arise when the auditor accepts to audit tasks that he contributed in achieving and a previous opinion was issued on them.

*Table 7Self-review threats*

	Mean	Std. Deviation
One of the team become an officer in the client enterprise, I expect that he has an impact on the results of the audit	4.4706	.50077
An auditor provides service to the client, it will affect the audit process currently or in the future	4.0784	.59082
An auditor prepared the basic data for the client that used in the preparation of financial statements, it will affect the audit process	4.2941	.45714
Valid N (listwise)		

The study further discovered that One of the team become an officer in the client enterprise, I expect that he has an impact on the results of the audit. It indicated that a mean response of 4.47, and (SD=.500) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. So the result show that one of the team becomes an officer in the client enterprise, I expect that he has an impact on the results of the audit.

The study regarding of an auditor provides service to the client, it will affect the audit process currently or in the future. It indicated that a mean response of 4.07, and (SD=.590) this was also reflected in the descriptive analysis were most of respondents are agreed. So the result show that an auditor provides service to the client, it will affect the audit process currently or in the future.

The study revealed that an auditor prepared the basic data for the client that used in the preparation of financial statements, it will affect the audit process. It indicated that a mean

response of 4.29, and (SD=.457) this was also reflected in the descriptive analysis were most of respondents are agreed. Therefore we can conclude an auditor prepared the basic data for the client that used in the preparation of financial statements, it will affect the audit process

#### 4.2.5 Advocacy threats

These threats arise when the auditor supports the client in his practices and in his views, or promotes his shares or defend him in court cases, or intervene to support the client position in any facing with others.

*Table 8 Advocacy threats*

	Mean	Std. Deviation
the auditors independence is affected when an auditor is acting in secret as an advocate in litigation or other disputes on behalf of a client.	3.8235	.38247
the auditors independence is affected when an auditor promote the shares of the client and his ideas	4.2745	.44773
The auditor should have an audit team which collect evidence for the subsequent periods rather than rely on the management information	4.5686	.49689
the auditors independence is affected when An auditor recommends a close friend through a dummy to trade in shares or financial securities	3.6667	.47295
Valid N (listwise)		

According to the table above, majority of the respondents agreed to the auditors independence is affected when an auditor is acting in secret as an advocate in litigation or other disputes on behalf of a client. It indicated that a mean response of 3.82, and (SD=.382) this was also reflected in the descriptive analysis were most of respondents are agreed. Therefore we can conclude the auditors independence is affected when an auditor is acting in secret as an advocate in litigation or other disputes on behalf of a client.

The study further discovered that the auditors independence is affected when an auditor promote the shares of the client and his ideas. It indicated that a mean response of 4.27, and (SD=.447) this was also reflected in the descriptive analysis were most of respondents are strongly agreed.

Therefore we can conclude the auditors independence is affected when an auditor promote the shares of the client and his ideas.

The study revealed that the auditor should have an audit team which collect evidence for the subsequent periods rather than rely on the management information. It indicated that a mean response of 4.56, and (SD=.496) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude an audit team which collect evidence for the subsequent periods rather than rely on the management information.

The study regarding of the auditors independence is affected when an auditor recommends a close friend through a dummy to trade in shares or financial securities. It indicated that a mean response of 3.66, and (SD=.472) this was also reflected in the descriptive analysis were most of respondents are agreed. Therefore we can conclude the auditor’s independence is affected when an auditor recommends a close friend through a dummy to trade in shares or financial securities.

#### 4.2.6 Familiarity threats

An auditor may work with client for a long time, this assists in increasing the auditor’s knowledge about the client’s activities.

*Table 9 Familiarity threats*

	Mean	Std. Deviation
The auditor’s independence is affected when auditing the same client and a family member holds a position with a client.	4.2157	.75168
The auditor’s independence is affected a family member holds a position with a client.	4.0784	.43724
the auditors independence can be affected under short audit tenure when an auditor accepts undue hospitality or gifts from a client	4.6863	.46553
the auditors independence can be affected when an auditor accepts undue hospitality or gifts from a client	4.3725	.48507
Valid N (listwise)		

According to the table above, majority of the respondents agreed to the auditor’s independence is affected under when a family member holds a position with a client. It indicated that a mean

response of 4.21, and (SD=.751) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude the auditor's independence is affected when a family member holds a position with a client.

The study regarding of the auditor's independence is affected when a family member holds a position with a client. It indicated that a mean response of 4.07, and (SD=.437) this was also reflected in the descriptive analysis were most of respondents are agreed. Therefore we can conclude the auditor's independence is affected when a family member holds a position with a client.

The study revealed that the auditor's independence can be affected when an auditor accepts undue hospitality or gifts from a client. It indicated that a mean response of 4.68, and (SD=.465) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude the auditor's independence can be affected when an auditor accepts undue hospitality or gifts from a client.

The study further discovered that the auditor's independence can be affected when audit time is long and when an auditor accepts undue hospitality or gifts from a client. It indicated that a mean response of 4.37, and (SD=.485) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude the auditor's independence can be affected under long relationship when an auditor accepts undue hospitality or gifts from a client.

#### 4.2.7 Intimidation threats

The client may threaten the auditor with canceling the contract between them in order to reduce his fees; this may reduce the objectivity of the auditor.

*Table 10 Intimidation threats*

	Mean	Std. Deviation
the auditors independence can be affected when an auditor is threatened with disciplinary action by a regulatory body of a client.	4.4510	.49923

the auditors independence can be affected under long relationship when an auditor is threatened with disciplinary action by a regulatory body of a client.	4.2549	.43724
The client that threatens the auditor to replace with another auditor as a result of a dispute between them can affect the auditor's independence.	4.3922	.56470
Valid N (listwise)		

According to the table above, majority of the respondents strongly agreed to the auditors independence can be affected when an auditor is threatened with disciplinary action by a regulatory body of a client. It indicated that a mean response of 4.45, and (SD=.499) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude the respondents strongly agreed to the auditors independence can be affected when an auditor is threatened with disciplinary action by a regulatory body of a client.

The study revealed that the auditors independence can be affected under long relationship when an auditor is threatened with disciplinary action by a regulatory body of a client. It indicated that a mean response of 4.25, and (SD=.437) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude the auditors independence can be affected under extended audit tenure when an auditor is threatened with disciplinary action by a regulatory body of a client.

The study regarding often client that threatens the auditor to replace with another auditor as a result of a dispute between them can affect the auditor's independence. It indicated that a mean response of 4.39, and (SD=.564) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude the client that threatens the auditor to replace with another auditor as a result of a dispute between them can affect the auditor's independence .

#### **4.2.8 Auditor independence (Dependent Variable)**

Auditor independence is the foundation of the auditing profession (Abu Bakar and Ahmad,

2009). Also, according to Independence Standard Board (2000) auditors independence is the freedom from those pressures and other variables that compromise an auditor's capacity to make unbiased audit choices or can reasonably be anticipated to compromise

*Table 11 Dependent Variable*

	Mean	Std. Deviation
Auditors exercise their independence as an auditor in their audit firms during the audit duties	4.2941	.77699
The value of auditing depends heavily on the independence of auditors in mind and appearance	4.1569	.36487
Audit firms support auditor's independence when undertaking audit duties	3.6471	.47945
Reliable audit report performed by independent auditors are very important for financial statements users	4.3922	.48983
The audit work is conducted in compliance with audit standards.	4.4706	.50077
Valid N (listwise)		

According to the table above, majority of the respondents strongly agreed to auditors exercise their independence as an auditor in their audit firms during the audit duties. It indicated that a mean response of 4.29, and (SD=.776) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude auditors exercise their independence as an auditor in their audit firms during the audit duties.

The study regarding of the value of auditing depends heavily on the independence of auditors in mind and appearance. It indicated that a mean response of 4.20, and (SD=.364) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude that the value of auditing depends heavily on the independence of auditors.

The study revealed that audit firms support auditor's independence when undertaking audit duties. It indicated that a mean response of 3.64, and (SD=.479) this was also reflected in the descriptive analysis were most of respondents are agreed. Therefore we can conclude audit

firms support auditor's independence when undertaking audit duties

The study further discovered that reliable audit report performed by independent auditors are very important for financial statements users. It indicated that a mean response of 4.40, and (SD=.489) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude reliable audit report performed by independent auditors are very important for financial statements users

The study regarding of the audit work is conducted in compliance with audit standards. It indicated that a mean response of 4.47, and (SD=.500) this was also reflected in the descriptive analysis were most of respondents are strongly agreed. Therefore we can conclude the audit work is conducted in compliance with audit standards

### **4.3 Inferential Statistics**

#### **4.3.1 Correlation Analysis**

Correlation is a measure of association between two variables, According to Kothari, (2004), positive variables of "r" indicate positive correlation between the two variables (i.e., changes in both variables take in the stated direction), whereas negative values of "r" indicate negative correlation i.e., changes in to the two variables taking place in the opposite directions. A zero (0) value of "r" indicates that there is no association between the two variables (independent and dependent variables). When  $r = (+) 1$ , it indicates perfect positive correlation and when  $r = (-) 1$ , it indicates perfect negative correlation. The relationship between two variables will be: a correlation of .10 is described as a small effect size, a correlation of .30 is described as a medium effect size and a correlation .50 is described as a large effect size. The correlation coefficient (r) ranging from 0.10 to 0.29 may regarded as indicating a low degree of correlation, r ranging from 0.30 to 0.49 may considered as a moderate degree of correlation, and r ranging from 0.50 to 1.00 may be regarded as a high degree of correlation Cohen, (1988).

Table 12 Correlation Analysis

		Auditor independence
independence	Pearson Correlation	1
	Sig. (2-tailed)	
Audit fee	Pearson Correlation	.443**
	Sig. (2-tailed)	.000
Non Audit fee	Pearson Correlation	.455**
	Sig. (2-tailed)	.000
Self interest	Pearson Correlation	.521**
	Sig. (2-tailed)	.000
Self-review	Pearson Correlation	.201*
	Sig. (2-tailed)	.013
Advocacy	Pearson Correlation	.145
	Sig. (2-tailed)	.074
Familiarity	Pearson Correlation	.776**
	Sig. (2-tailed)	.000
Intimidation	Pearson Correlation	.280**
	Sig. (2-tailed)	.000

According to the Table , there is a significant positive relationship between the five auditor threats and auditor independence, the highest correlation is between familiarity and auditor independence (0.77) followed by Self-interest (0.52), Non Audit service (0.45) and the remaining Audit fee and Intimidation (0.44) and ( 0.28) respectively. The weakest correlation is between Advocacy and auditor independence whereas; the strongest correlation is between familiarity and auditor independence. In general, if correlation is positive between two or more variables that is, when factors affecting auditors independence and auditor independence is positively related.

#### 4.3.2 Regression Analysis

Regression analysis is a statistical method to deal with the formulation of mathematical model depicting relationship amongst variables which can be used for the purpose of prediction of the values of dependent variable, given the values of the independent variable tizitz taye,(2018)



To determine the effect of independent variable on the dependent variable regressions analysis was conducted. Regression analysis helps in establishing a functional relationship between two or more variables and predicts the values of dependent variables from the value of independent variables.

#### 4.3.2.1 Model Summary

The findings of coefficient of correlation R and coefficient of adjusted determination R<sup>2</sup> is as shown in the below Table

*Table 13 Model Summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.883 <sup>a</sup>	.781	.745	.10841

a. Predictors: (Constant), Intimidation, Self-interest, Audit fee, Advocacy, NonAudit, Self-review, Familiarity

The findings established that coefficient of correlation R was 0.88 indication of strong correlation with the variables. The findings also established that coefficient of adjusted R<sup>2</sup> was 0.78 which translates to 78.1%. This explains that 74.5% which means that the whole independent variables explains 74.5% of the variability of the dependent variable in the population. As table shows the regression model is statistically significant, since the  $p = 0.000 < 0.05$ . The residual of 25.5% can be explained by other factors beyond the scope of the current study.

#### 4.3.2.2 ANOVA Table

*Table 14 ANOVAa*

odel	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	3.326	7	.475	40.434	.000 <sup>b</sup>
Residual	1.704	145	.012		
Total	5.031	152			

a. Dependent Variable: independence

b. Predictors: (Constant), Intimidation, Self-interest, Audit fee, Advocacy, Non Audit, Self-review, Familiarity

The findings show that F Calculated was 40.434 and F Critical was .10841 an indication that F Calculated > F Critical an indication that the overall regression model was significant for the study. The study established that the p value was 0.00 which is less than 0.05 an indication that at least one variable significantly influenced auditor independence.

### 4.3.2.3 Regression Coefficients

In order to establish the individual influence of independent variables on dependent variables, the researcher conducted regression analysis.

Table 15 Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.234	.363		3.399	.001
Audit fee	.100	.038	.156	2.637	.009
Non Audit fee	.237	.264	.237	.777	.000
Self-interest	.230	.068	.324	3.364	.000
Self-review	-.070	.046	-.120	-1.518	.131
Advocacy	.136	.075	.103	1.815	.072
Familiarity	.377	.055	.590	6.886	.000
Intimidation	.326	.359	.330	.742	.000

a. Dependent Variable: auditor independence

The findings shows the influence of predictor variables on auditor independence, multiple linear regression analysis was computed. The above table shows that, predictor variables, i.e. ), Self-interest threats, Self-review threats, Advocacy threats, Familiarity threats, Intimidation threats and Audit fee a statistically significant influence/prediction in predicting the dependent variable, auditor independence.

The Beta coefficient result indicates that a change of one standard deviation in the predictor variable resulted in a change of standard deviations in the criterion variable. Thus, a

change of one standard deviation in Audit fee has 10% change of standard deviations on auditor independence. Since the higher the beta value the greater the effect of the predictor variable on the criterion variable.

In order to evaluate the contribution or influence of each independent variable to the dependent variable, we can see the Beta value. In the table above, the Beta value for predictor variable, Familiarity threats was .377 which implies that this predictor variable made the first strong positive and statistically significant influence in explaining or predicting the dependent variable auditor independence, when the variance explained by all other variables in the model is controlled.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

The aim of this chapter is to give a general summary about the whole study and make broad conclusions drawn from the findings of the results. Starting from problem identification of the study till to this point different document, theoretical perspectives and empirical analysis were analyzed to have better understand about research problem, to know what was done on it in previous, and which part needs further investigation. Based on the part of research problem that need more investigation the researcher tried his own best and finally want to put his final conclusions and recommendations. Therefore, this chapter of the study deals with the conclusions and recommendation of the study which is based on what is discussed in the previous chapters and the main finding of this study. Finally, based on the findings the researcher put some recommendations under this chapter.

#### **5.1. Summary of Major Findings**

According to findings from the questionnaire responses, Competition between audit firms on audit fee affect auditor independence when the client fees represent more than 15% of the auditor revenue under extended and short audit tenure, affect auditor's independence. However large size of audit fees is not associated with a higher risk of losing the auditor's independence. The mean aggregate agreement level is  $M=3.51$  as high mean score this was also reflected in the descriptive analysis were most of respondents are agreed.

Findings from the questionnaire responses show that, An auditor has had a client for less than 1 year; the auditor also provides non audit services to the client. The value of the non-audit fees is equal to 25% or greater than 100% of the audit fees affect auditor independence and an economic bond between the auditors and the client that can compromise auditor independence. The mean aggregate agreement level is  $M=3.74$  as high mean score this was also reflected in the descriptive analysis were most of respondents are agreed.

According to findings from the questionnaire responses, self-interest threats affect auditor independence when the client a material interests directly and indirectly, custom to lend client or borrow from him, there is a probability to become an officer in the client enterprise and the auditor's concern about the possibility of losing the engagement. The mean aggregate agreement level is  $M=4.20$  as high mean score this was also reflected in the descriptive analysis were most of respondents are strongly agreed.

Findings from the study self-review threats affect audit independence when the client one of the team become an officer in the client enterprise, he has an impact on the results of the audit on users, an auditor provides service to the client, it will affect the audit process currently or in the future and the auditor prepared the basic data for the client that used in the preparation of financial statements, it will affect the audit process under long audit. The aggregate mean response of the questions under this is 4.28, which is close to 4 in Liker scale and has high value this was also reflected in the descriptive analysis were most of respondents are strongly agreed.

As identified by the study, auditors independence is affected when an auditor is acting in secret as an advocate in litigation or other disputes on behalf of a client, selling or underwriting shares of a client threatens the auditor independence and the auditor recommends a close friend through a dummy to trade in shares or financial securities. However the auditor should have an audit team which collect evidence for the subsequent periods rather than rely on the management information. The mean aggregate agreement level is  $M=4.08$  as high mean score this was also reflected in the descriptive analysis were most of respondents are agreed.

The study shows that auditor's independence is affected when family member holds a position with a client and the auditor accepts undue hospitality or gifts from a client. The mean aggregate agreement level is  $M=4.33$  as high mean score this was also reflected in the descriptive analysis were most of respondents are strongly agreed.

The study reveals that auditor's independence is affected under when an auditor is threatened with disciplinary action by a regulatory body of a client and the client that threatens the auditor to replace with another auditor as a result of a dispute between them. The mean aggregate agreement level is  $M=4.36$  as high mean score this was also reflected in the descriptive analysis

were most of respondents are strongly agreed.

## **5.2 Conclusions**

Based on the findings of the study, the following main conclusions are drawn. The aim of the study is to explore factors affecting auditor's independence. Auditor independence was considered from the viewpoint of the external auditors. The study decided to use the threats to auditor independence in order to appraise the impairment of auditor independence.

The study concludes that the main purpose was geared towards finding out factors affecting auditors independence. Then, we decided to use the threats to auditor independence in order to appraise the impairment of auditor independence considering factors affecting auditors independence as a source of the increase likelihood of more threats to independence and the results of our findings indicated an association of auditor independence to factors affecting auditors independence. Though the statistical results showed the specified factors significantly affect auditor's independence.

According to the findings, The study concludes factors that impair auditors independence can be a source for the emergence of threats to auditor independence .

As mentioned in an earlier chapter, when there are safeguards to threats to independence, it may not necessarily guarantee that the auditor independence is free from the damage of threats. These safeguards will require that the auditors strictly follow them to ensure that their independence which is their core value is unperturbed.

## **5.3 Recommendations**

The study recommends that safeguarding to threats to independence; it may not necessarily guarantee that the auditor independence is free from the damage of threats. These safeguards will require that the auditors strictly follow them to ensure that their independence which is their core value is undisturbed.

The study recommends that the result from the study indicates that threats to auditors independence have impacts on auditors independence and audit quality even if the impact

is worst in case threats affect collectively. This shows that the auditor should be free from any factors that impair his independence.

The study recommends auditors to recognize threats and their impact on independence, and tolerate by the rules of professional behavior and hedge against these threats by taking defensive procedures which are consistent with each threat.

The findings recommends that establishing a country-level quality assurance program is an international good practice. A quality assurance program checks the auditors work at both partner and firm level, and ensures that auditors conduct their duties with outmost professional diligence. However, as it is mentioned by World bank (2007), not only Addis Ababa but also Ethiopia does not have a quality assurance program for auditors. Therefore, to ensure that audit firms and auditors have effective quality control arrangements, a mechanism of a quality assurance program for auditors must be in place. However such a review mechanism does not exist in Ethiopia.

#### **5.4 Research Limitation and Further Research Directions**

From broadest and most interesting topics of audit, the constraint of the study was limited to the factors affecting auditors independence in the context of Addis Ababa area; this study is not without limitations. Some of the limitations are

The dimension of factors affecting auditors independence in the context of Addis Ababa area are very wide, in this study only factors affecting auditors independence in the context of Addis Ababa area are examined.

Sufficient studies are not done on factors affecting auditor's independence in the context of Addis Ababa area especially by using many independent variables. The researcher believes the study will be an input for further studies on extended audit tenures on audit independence in Addis Ababa area and the researcher believes that this study is deep; it is still believed that it can be further extended by including additional factors and respondents from clients of the auditors in different departments to make it more realistic and more reliable. Finally, further research needs to contain more desirable dimensions, to gain better insight

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## **APPENDIX: Questionnaire**

### **ST MARY UNIVERSITY**

#### **MASTERS OF ARTS PROGRAM IN ACCOUNTING & FINANCE**

Dear respective respondents

I am a post graduate student in Accounting & Finance and I am conducting my senior thesis on the title “**The Impacts of Extended Audit Tenure on Auditor’s Independence in the Context of Private Audit Firms in Addis Ababa**” and the objective of this questionnaire is to collect data from Private Audit Firms in Addis Ababa which help to measure the Impacts of Extended Audit Tenure on Auditor’s Independence. The information collected shall be used for research purpose only. I assure you that your responses will not be disclosed in any way and utmost confidentiality will be maintained. Hence, I request your sincere cooperation for the successful undertaking of the study and your valuable response is highly appreciated.

Thank you!

#### **Note**

- Please put “√” mark in the box to the point which highly reflects your idea?
- Your honest and unbiased response will greatly contribute for the research to achieve its objective and there is no need to write your name.

Thank you very much, in advance, for your sincere cooperation. If you have any comment and questions you can contact me through the following address;

*haregewoin G/hiwot*(+251912091580) ([haregmek2019@gmail.com](mailto:haregmek2019@gmail.com))

## **PART I: General Information about the Respondents**

The following questions ask about your personal information. Compilation & confidentiality of the information will be made with due care. No individual data will be reported. Please put  $\surd$  or X mark for item/s you selected.

### **1. Gender:**

Female  Male

### **2. Age:**

20-30 year's old  31-40 years old

41-50 years old  above 51 years' old

### **3. The educational Background**

TVET, Diploma  Bachelor's Degree

Master's degree  other

### **4. Years of work experience as auditor**

Less than 5 years'  6 - 10 year's

11 - 20 year's  over 20 year's

## Part II Closed Ended Questions

The Following Questions are presented on a five point liker Scale. If the item strongly matches with your response choose 5 (strongly Agreed), if you moderately agree on the idea choose 4 (Agreed), if you can't decide on the point choose 3 (I don't know), if you disagreed with the idea choose 2 (Disagreed), and if you completely disagreed with the point choose 1 (Very disagreed).

5 = strongly Agreed

4 = Agreed

3 = neutral (I don't know)

2 = Disagreed

1 = strongly Disagreed

To what extent do you think that the situations described below can affect auditors Independence?

Audit fee						
No.	Description	Strongly Agree	agree	neutral	Disagree	Strongly disagree
1	the auditors independence is affected when the clients fees represent more than 15% of the auditors revenue for new audit firms					
2	the auditors independence is affected when the clients fees represent more than 15% of the auditors revenue for permanent audit firm					
3	Competition between audit firms on audit fee will affect auditors independence					
4	Large size of audit fees is normally associated with a higher risk of losing the auditor's independence					

<b>Non Audit Services</b>						
No.	Description	Strongly Agree	agree	neutral	Disagree	Strongly disagree
1	The auditor also provides non audit services to the client. The value of the non-audit fees is equal to or greater than 100% of the audit fees.					
2	The auditor also provides non-audit services to the client. The value of the non-audit fees is up to or equal to 25% of the audit fees.					
3	non-audit related services can create an economic bond between the auditors and the client that can compromise auditor independence					

<b>Self-interest threats</b>						
No.	Description	Strongly Agree	agree	neutral	Disagree	Strongly disagree
1	the auditors independence is affected when a material interests directly and indirectly with the client					
2	The auditor's independence is affected when custom to lend client or borrow from him.					
3	The auditor's independence is affected when there is a probability to become an officer in the client enterprise					
4	The auditor's independence is affected when the auditor's concern about the possibility of losing the engagement					

	<b>Self-review threats</b>					
1	One of the team become an officer in the client enterprise, I expect that he has an impact on the results of the audit					
2	An auditor provides service to the client, it will affect the audit process currently or in the future					
3	An auditor prepared the basic data for the client that used in the preparation of financial statements, it will affect the audit process					
	<b>Advocacy threats</b>					
1	the auditors independence is affected when an auditor is acting in secret as an advocate in litigation or other disputes on behalf of a client.					
2	the auditors independence is affected when an auditor promote the shares of the client and his ideas					
3	The auditor should have an audit team which collect evidence for the subsequent periods rather than rely on the management information					
4	the auditors independence is affected when An auditor recommends a close friend through a dummy to trade in shares or financial securities					
	<b>Familiarity threats</b>					
1	The auditor's independence is affected when auditing the same client and a family member holds a position with a client.					
2	The auditor's independence is affected a family member holds a position with a client.					
3	the auditors independence can be affected when an auditor accepts undue hospitality or gifts from a client					
4	the auditors independence can be affected					

	when an auditor accepts undue hospitality or gifts from a client					
	<b>Intimidation threats</b>					
1	the auditors independence can be affected under short audit tenure when an auditor is threatened with disciplinary action by a regulatory body of a client.					
2	the auditors independence and audit quality can be affected under extended audit tenure when an auditor is threatened with disciplinary action by a regulatory body of a client.					
3	The client that threatens the auditor to replace with another auditor as a result of a dispute between them can affect the auditor's independence under extended audit tenure.					
	<b>Auditor independence</b>					
1	Auditors exercise their independence as an auditor in their audit firms during the audit duties					
2	The value of auditing depends heavily on the independence of auditors in mind and appearance					
3	Audit firms support auditor's independence when undertaking audit duties					
4	Reliable audit report performed by independent auditors are very important for financial statements users					
5	The audit work is conducted in compliance with audit standards.					