ST.MARY'S UNIVERSITY

BUSINESS FACULITY

DEPARTMENT OF ACCOUNTING

AN ASSESSMENT OF FACTORS AFFECTING EXTERNAL AUDITORS INDEPENDENCY IN PRIVATE AUDIT FIRMS

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July 2014

ADDIS ABABA

AN ASSESSMENT OF FACTORS AFFECTING EXTERNAL AUDITORS INDEPENDENCY IN PRIVATE FIRMS

IN ST.MARY'S UNIVERSITY

A SENIOR ESSAY SUBMITTED TO THE DEPARTMENT OF ACCOUNTING BUSINESS FACULTY

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IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF BACHELOR OF ARTS IN ACCOUNTING

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APPROVED BY THE COMMITTEE OF EXMINERS

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Internal Examiner	Signature
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External Examiner	Signature

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CHAPTER ONE

1. Introduction

1.1. Background of the study

In any company, internal financial controls are important to safeguard misuse of company funding and fraudulent activity. Hiring an external auditing firm is a prudent management decision. Outside audits help review the integrity of company's financial activity. External audits perform the function of testing company controls and transactions. Typically, on an annual basis, an external audit firm provides a written report to the senior management and their board of directors regarding an organization's financial statement. An external auditor is typically used to avoid conflicts of interest and to ensure the integrity of the auditing process. The primary role of external auditors is to express an opinion on whether an entity's financial statements are free of material misstatements.

As identified by Arans and Lobbeck (1999) the financial reports obtained from firms needs to be fair and qualified because this financial reports are disclosed to external parties like banks, governmental bodies, supplier and the like. These external users of business firm need assurance on the fairness and reliability of these financial reports. In order have to fair and reliable financial report; it must be audited by an independent party outside from the business firm. The Ethiopian commercial code of 1960 (Art 368-387n) stated about the requirement of financial statements audit on annual bases, which means audit must be performed by competent, independent professional that is consists with internationally accepted standard. The independency of the independent or external auditor is an essential component of the audit relationship. It is

fundamental to the independent auditor's accountability to the audit committee, the performance of the audit and the confidence investors may place on the auditor's report. The independency of external auditor is one of the important issue the auditor has received considerable attention since the very beginning of the composition of the audit profession, and with the recognizing the importance of the audit profession in the opinion impartial technical for the sincerity and fairness of financial statements to express clearly the result of business and financial position of the company in the audit, but the conflict is high between the border and the beneficiaries of the audit results may be display the independence of auditor in the exercise of his profession to some of the pressure which is likely to lead him to change course or abandon it.

As of official website of auditors general (OFAG, 2014) showed that there are 71 external auditing firms in Ethiopia in which OFAG classified them as A, B and C. ROSC (2007) discussed that in under developed countries even in East Africa, there is neither a strong local professional association nor local identification of accountants and also there is no cut point on which auditing standards is currently in use. However the current move of the OFAG that has a mandate of license and supervise private audit firms in Ethiopia which is designed in accordance with the international which is published in 2009. OFAG fully supervise private audit firms to ensure that audit has been conducted in accordance with professionally accepted manner. Nick et al (2008) conclude that GAAS (Generally Accepted Auditing Standards) requires that an auditor be impartial and act without bias towards the client. Most of Audit firms practice in Ethiopia do not give emphasis to auditors' independence and from some issues in audit and the issue of independency should be given more emphasis.

1.2. Statement of the problem

Auditor's independency in performing audit has a great role for the fairness of the client's financial report. In order to perform their role, it's essential that auditors are independent of the client company and are not seen to have and motive for nondisclosure of wrong information (Lavin, 1997)

Independency of Auditor in conducting financial statement audit is stated under the commercial code of Ethiopia of 1960 and the role of professional code of ethics for accounts issued by office of Auditors General (OFAG) states that auditors should be free of conflict interest while they are in the engagement of audit. But in some cases it seems independency does not exist because there is a different audit opinion of different auditors in a single client company.

Research question

After the completion of the study, the researchers tried to answer the following research questions:

1. What are the factors that make auditors and audit firms violet the requirement of independency?
2. Do private audit firms apply the requirement of independency in Professional conduct and legal provision?

1.3. Objective of the study

1.3.1. General objectives

The general objective is to evaluate the independency of auditors relating with the standard and legal provision and the professional requirement of independency by taking some selected private audit firms in Ethiopia.

1.3.2. Specific objectives

These are:

1. To evaluate whether internal factors that are in the client company like incentives made by the staff members of the client company to the auditor's gift, money and other kind of intensives affect auditor's independency.

2. To see the external factors that impair auditor's independency, some of these factors are;

- The extent to which the internal auditors authority given by the external auditors
- The auditors different level of negligence (simple negligence, negligence and fraud)

1.4. Significance of the study

This study gives the following benefits

- It gives understanding to the public about the independency of private audit firms.
- This paper serves as a document to help other researchers who study related or same topic.
- Fulfill the BA requirement.

1.5. Research Methodology

1.5.1. Research Design

For the successful completion of the study a descriptive research used in order to get background knowledge and better understanding by identifying and assessing factors that affect external auditors' independency in privet audit firms

1.5.2. Population and sampling technique

Privet audit firms were taken as a population. Therefore the population has 71 privet audit firms (OFAG 2014). From the total population 10% or 7 privet audit firms were taken as a sample and to conduct this study, the researchers also considered the three types of auditors' level while distributing the questionnaire, and used non probability sampling. There is an assumption that there is an even distribution of characteristics within the population. This is what makes the researchers believe that it is a homogenous population which any sample would be representative and because of that, results will be accurate. And from non-probability sampling the researchers used convenience sampling.

1.5.3. Types of data to be collected

Primary data

Clothe ended questionnaires with clear requisitions to audit firm staffs on the selected Audit firms were distributed. Questionnaires required responses about their competence and position in audit factors which are internal and external affecting auditor's independency.

Secondary data

The researchers used the manuals in firms under consideration of the sample audit firms as reference books and conducted research.

1.5.4. Method of data collection

A well designed questionnaire were prepared and distributed to the auditors in the selected privet audit firms.

1.5.5. Data analysis method

The data gathered through questionnaire, edited as to its completeness, consistence and the researchers used a descriptive analysis and the result presented by using tables and graphs and discussed on the result.

1.6. Scope of the study

The research only focus only in privet audit firms and took 7 private audit firms from the 71 privet audit firms in Ethiopia OFAG (2014) as a sample, because the sample taken covers 10% of the population and the researchers believed that it represent the total population.

1.7. Limitation of the study

Researchers came across some difficulties while conducting the research. These are:

- Privet audit firms in Addis Ababa are scattered so that the researchers were unable to reach more firms than the samples selected in this research within the given period.

Some questionnaires were filled carelessly and others were not returned.

1.8. Organization of the Study

The research has four chapters. The first chapter is about introduction, statement of the problem objective of the study, significant of the study, research methodology, Methods of data presentation and analysis and organization of the study, chapter two deals with literature review, the third chapter is about data analysis and presentation of the study. The last chapter, chapter four also describes findings of the study, conclusion and recommendation.

CHAPTER TWO

2. Literature Review

2.1. Independency of Auditors

Auditing is the examination by an independent accountant of the financial data, accounting records, business documents and other documents of an organization in order to attest the fairness of financial statements (champ, 2002).

The value of the Auditing depends heavily on the public perception of the perception of the independence of the auditors. Independence in auditing means taking un-biased viewpoint in performing audit tests, evaluating the results and issuing the audit reports. If the auditor is an advocate of a client, or anyone else the auditor cannot be considered as independent. Independence is regarded as the auditor most critical characteristics, because many users are willing to rely on the CPA's reports as to the fairness of the financial statements is their exception of unbiased viewpoint (Aranes and Lobeck, 1999).

As sited in Fearnely, Beattie and Brandt (2005) over many years, practitioners and academics have struggled to find definitions for independence in the audit context. Perhaps the best known definition in the academic literature is that of De Angelo (1981) 'the conditional probability of reporting a discovered breach'. Others include: 'the ability to resist client pressure' (Knapp 1985); 'and attitude/state of mind' (Schuetze 1994); a function of character with the integrity and trustworthiness being key (Magill and Prevists 1991). More recent definitions contained in pronouncements from various representative bodies of the profession worldwide extend the definition of a state of mind, for example, freedom from those pressures and other factors that compromise, or can reasonably be expected to compromise, an auditors' ability to make unbiased audit decisions (independence standards board (ISB) 2000).

It is important that the users of the financial statements to have a confidence if the auditor is independent. The objectives are identified as "**independent in fact** "and "independent **in appearance** ". The first one exists when the auditor is actually able to maintain unbiased and fair auditing process where as the second one is the result of other interpretation of independency. Even if the auditors are independent in fact but users may believe them to be advocators of for the client (Aranes and Lobeck 1999).

Auditors cannot be considered as independent if the following criteria's are seen to be happening

- If the auditor serve as an employee or officer of the clients company
- If an auditor is partner in the clients company.
- If the auditor is debited to the company for an amount exceeding 1000.

2.1.1. Internal auditors

These Auditors are employed by the companies to audit for the management and most of the time these auditors are not independent because most of the time they are staff members of the client's company and compliance audit is performed by these auditors.

2.1.2. External auditors

These are auditors which are certified and independent auditors and usually work on their own by establishing private audit firms. These auditors are not allowed to audit governmental organizations, and the researchers tried to focuses on factors affecting the independency of these auditors.

Who can conduct an audit?

Audit must be performed by independent auditors. A study by (Pany 2001) showed that it should be performed by an independent and competent person and these critical requirements of auditor are also taken by professional body in accounting and auditing as well as by government agencies that provide likeness to be an auditor as a key requirement.

2.2. Professional Code of Conduct

AICPA (American Institution of Certified Public Accountant) code of professional conduct provides both the general standards of ideas conduct and specific enforceable rules of conduct. It has four parts.

- **Principles**

  These are ideas, standards of ethical conduct stated in philosophical term.

- **Rule of conduct**

  These are minimum standards of ethical codes stated and no specific rules.

- **Interpretation of rules and conduct**

  It is the interpretation of the rules by the AICPA division of professional ethics.

- **Ethical Ruling**

2.3. Auditor Independency

As pointed out by " financial times, 2012 that Auditor independency can be defined as a reference to the independence of internal or external auditors from parties that might have a financial inters in business being audited.

Independency requires:

- Independency of mind - the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.
- Independency in appearance - the avoidance of facts and circumstances that are so significant that a reasonable and informed third party , having knowledge of all relevant information, including safeguard applied, would reasonably conclude a firm, or a member of the assurance team's integrity, objectivity or professional skepticism had been compromised.

  Independency is fundamental to the reliability of auditors' reports. Those reports would:

- ✓ Not be credible , and investors and creditors would have little confidence in them
- ✓ Be an objectively presented
- ✓ Be fairly in conformity with generally accepted accounting principles. As expressed by council of The American Institute of Certified Public Accountant (AICPA) in a statement adopted in 1974: Independence, both historically and philosophically, is the foundation of the public accounting profession and upon its maintenance depends the profession's strength and its stature.

The use of the word "Independence" on its own may create misunderstandings. Standing alone, the word may lead observers to suppose that a person exercising professional judgment ought to be free from all economic, financial and other relationship. This is impossible, as every member of society has relationships with others. Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonable conclude to be unaccepted.

In an important chronicle of accounting profession, Jhon L. Carey described independency as a state of mind and a matter of character. In the early part of the 20thcentury, the concepts of integrity, honesty and objectivity were so familiar and ingrained that it was not considered necessary to have formal independence rules. The profession felt that written rules merely would have stated the obvious.

In 1932, AICPA council considered prohibitions against auditors serving as officers or directors of clients, and rejected them as unnecessary. However, the proposal indicated the first concerns over a need to preserve the appearance of maintaining objectivity, as well as being independent in fact. After the securities Act of 1933 was enacted, the Federal Trade Commission tons applicable regulations stating that it would not consider auditors to be independent if they served as officers or directors of, or had any direct or indirect interests in; public audit clients. The concern was that these client relation might sub consequently impairs the auditors' objectivity. This in effect introduces the appearance as well as the fact of independence as an independence concept. Carey later noted that no one would accuse an auditor who owned a few shares in a client company of losing integrity, but " what would other people think what would the public think?" In 1941 the AICPA adopted similar prohibition applicable to all clients, not just public companies.

Independency in auditing means taking an unbiased view audit in performing audit test, evaluating the results and issuing audit report a member in public practice shall be independent in performing professional services as required by standard stated by bodies designated by council. Auditors should be independent by concerning the two ideas of independency in fact means implies to CPAs ability to maintain an objective and impartial mental attitude through the engagement and independency in appearance refers to the relation between the CPAs and their clients have to appear to be independent to the third parties.

Importance of the Auditor Independence

It is important for an audit to be independent because it will allow any third party to rely on any information and it equally adds credibility to the audit.

2.4. Factors that impairs Auditors Independency

James et al (2002) have proposed that there are many factors that impair auditors' independency. The main factor is "Financial Interest" occurred when the Auditor maintains some financial interest in the clients company. Financial interest comes to the picture when there is investment. Investment may be in the form of direct or indirect investment.

2.4.1. Direct Versus Indirect Investment

The ownership of stock or other equity shares and debt securities by members or their immediate family is called a **direct financial interest**. For example, if either a partner in the office in which an audit is conducted or the partner's spouse has a financial interest in a company, the CPA firm is prohibited from expressing an opinion on the financial statements of that company.

An **indirect financial interest** exists when there is a close, but not a direct, owner - ship relationship between the auditor and the client. An example of an indirect ownership interest is the covered member's ownership of a mutual fund that has an investment in a client.

2.4.2. Bookkeeping and other services

If a CPA records transaction in the journals for the client, posts monthly totals to the general ledger, makes adjusting entries, and subsequently does an audit, there is some question as to whether the CPA can be independent in the audit role. The interpretations permit a CPA firm to do both bookkeeping and auditing for a private company audit client. The AICPA's conclusion is presumably based on a comparison of the effect on independence of having both bookkeeping and auditing services performed by the same CPA firm with the additional cost of having a different CPA firm do the audit.

There are three important requirements that the auditor must satisfy before doing bookkeeping and auditing for the client:

1. The client must accept full responsibility for the financial statements. The client must be sufficiently knowledgeable about the enterprise's activities and

financial condition and the applicable accounting principles so that the client can reasonably accept such responsibility, including the fairness of valuation and presentation and the adequacy of disclosure. When necessary, the CPA must discuss accounting matters with the client to be sure that the client has the required degree of understanding.

2. The CPA must not assume the role of employee or of management conducting the operations of an enterprise. For example, the CPA cannot consummate transactions, have custody of assets, or exercise authority on behalf of the client. The client must prepare the source documents on all transactions in sufficient detail to identify clearly the nature and amount of such transactions and maintain accounting control over data processed by the CPA, such as control totals and document counts.

3. The CPA, in making an audit of financial statements prepared from books and records that the CPA has maintained completely or in part, must conform to auditing standards. The fact that the CPA has processed or maintained certain records does not eliminate the need to make sufficient audit tests.

The first two requirements are often difficult to satisfy for a smaller company with an owner who may have little knowledge of or interest in accounting or processing transactions.

The AICPA independence rules require members to adhere to more restrictive independence rules of other regulatory bodies, such as the SEC. As a result, it is not permissible for an audit firm to provide bookkeeping services to a public company audit client under both SEC rules and the AICPA rules on independence.

2.4.3. Normal Lending Procedures

Generally, loans between a CPA firm or covered members and an audit client are prohibited because it is a financial relationship. There are several exceptions to the rule, however, including automobile loans, loans fully collateralized by cash deposits at the same financial institution, and unpaid

credit card balances not exceeding $1000 in total. It is also permissible to accept a financial institution as a client, even if covered members of the CPA firm have existing home mortgages, other fully collateralized secured loans, and immaterial loans with the institution. No new loans are permitted, however. Both the restrictions and exceptions are reasonable ones, considering the trade-off between independence and the need to permit CPAs to function as businesspeople and individuals.

2.4.4. Director, Officer, Management, or Employee of a Company

If a CPA is a member of the board of directors or an officer of a client company, his or her ability to make independent evaluations of the fair presentation of financial statements is affected. Even if holding one of these positions did not actually affect the auditor's independence, the frequent involvement with management and the decisions it makes is likely to affect how statement users perceive the CPA's independence. To eliminate this possibility, interpretations prohibit covered members, partners, and professional staff in the office of the partner responsible for the attest engagement from being a director or officer of an audit client company. Similarly, the auditor cannot be an underwriter, voting trustee, promoter, or trustee of a client's pension fund, or act in any other capacity of management, or be an employee of the company.

2.4.5. Serving Client Company repeatedly

It is believed that if the CPA gives auditing service for a single client more than 5 years, the CPA is becoming familiar to the client so that his or her independency will get under question.

Some threats to an auditor's independency are as followed

Self-interest threat – when the auditor on the engagement team could benefit in some way (financially for example) from the client.

Familiarity threat – when the auditor has some form of a close relationship with the client (be in the top management or employees, or the firm) which may cause them to be generous and sympathetic when assessing the client activities.

Intimidation threat – when the auditor is deterred from acting in an objective, professional manner as a result of threat (real or not) from the client.

Self-review threat – when the auditor is hired to review or evaluate any product or judgment that they themselves were responsible for preparing (from the previous engagement) in order to reach conclusion.

2.5. The Standard for independency

In matters relating to the audit work, the audit organization and the individual auditors, whether government or public should have an adequate degree of independency from the legislature and should consider not only weather they are independent and their attitude and belief perfect them to be independent but also weather there is anything about their situation that might lead other to question their independency. All situations deserve consideration because it is essential not only the auditors are in fact independent and impartial but also that knowledgeable third party consider themselves (ibid).

Quality control

According to international standard on quality control 1 (ISOC1),1 the audit firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and it personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances.

The elements of quality control policies adopted by an audit firm normally incorporate policies related to general firm activities and personal. General firm

activities for which quality control policies and procedures are required include leadership responsibilities for quality within the firm, acceptance and retention of clients, engagement performance, and monitoring. Quality controls applied to human resources include ethical requirements .they quality control policies and procedures should be documented and communicated to the firm's personnel (Hayest et al, 2005).

2.6. Solution for the Treats To Independency

To prevent treats to independency an auditor should not participate in auditing if

- He or she has a loan agreement with the client company except if the loan is made on normal terms that normal interest rate loan period and collateral.
- He or she has a family member who has a share in the client company for the preservation of independency the auditor should remove from the audit team.
- He or She provides bookkeeping service to on audit client since it will bring about self-review treat to independence. But bookkeeping service is allowed if the audit firm sends two separate teams bookkeeping and audit team, the audit client takes responsibilities for the financial statements.

In Addition to this

- Auditors in the engagement of audit practice must strictly follow professional as well as legal requirement made to maintain the auditors' independence and other fundamental requirements having implication on public confidence and /or overall audit quality.
- Audit must strictly follow the requirements and decide on the nature and type of organization on which offering audit and services other than audit.

Chapter Three

3. Data Presentation, Analysis & Interpretation

In this chapter, the researchers presented the results of the data analysis and its discussion. The analysis was made using the sample survey data gathered from private audit firms in Addis Ababa. After the responded questioners are edited as to their completeness and consistency the researcher made descriptive analysis and results are presented using tables & pie charts and discussions.

Even though the researchers have distributed 19 questioners, 2 of the questionnaires were not returned back & 3 of them were filled carelessly by the respondents, therefore the researchers have dropped 5 questioners and made the analysis using the remaining 14 questioners.

3.1. Personal information of respondent

Educational Qualification & Affiliation to professional Bodies

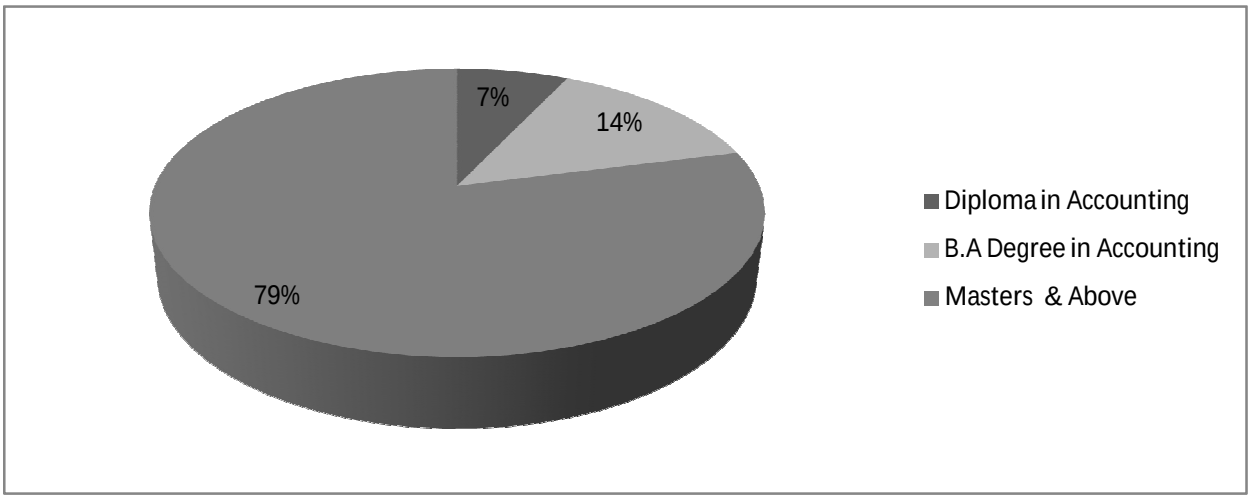


Figure1. Qualification

Source Questioner survey 201

The above pie chart shows that 79% of the respondents have their masters (MSC), 14% of the respondents have BA degree in accounting and the remaining 7% that is one person has diploma in accounting.

	Description	*Frequency Count*	Percentage
	Professional Body Affiliation		
	ACCA Student	6	43%
	ACCA Certified	3	21%
	CPA Student	0	
	CPA Certified	0	
	CIA Certified	0	
	Other	0	
	Not Affiliated	5	36%
	Total	14	100%

Figure 2 Affiliation to professional Bodies

Source Questioner survey 2014

As it is seen from the above table, the respondents of sample audit firms' workers in their professional body affiliations show that 6 of the respondents are students of ACCA, 3 of the respondents are ACCA certified and the remaining 5 respondents are not affiliated. In this case of our country, the association of chartered certified accountants & auditors (ACCA) is most common as the majority (64%) of respondents was found to be students & affiliated to this UK based professional body which is widely known in the world.

An individual can engage in auditing profession when he is certified degree or diploma in the field of accounting at the entry level and also expected to be certified on professional accounting and auditing examination administered by authoritative professional bodies in accounting and auditing. From this point of view, one can conclude that having a well-trained, qualified and also experienced staff member in audit firm will enhance auditor's independency.

	Explanation	*Frequency*	*Percentage*
	Less than one year	1	7%
	1 – 10 years	3	21%
	10 -20 years	4	29%
	Above 20 years	6	43%
	Total	**14**	**100%**

Figure 3 work experience

Source Questioner survey 2014

Experience in an audit firm is considered as a critical part if licensing auditor showing how important to audit firms must focus in enhancing experience mixes of audit staff. For one audit firm, having a well experienced staff members play a vital role in the engagement of audits for the audit firms, and as one can see here 72% of respondents stay in audit profession above 10 years which is good for their audit firm.

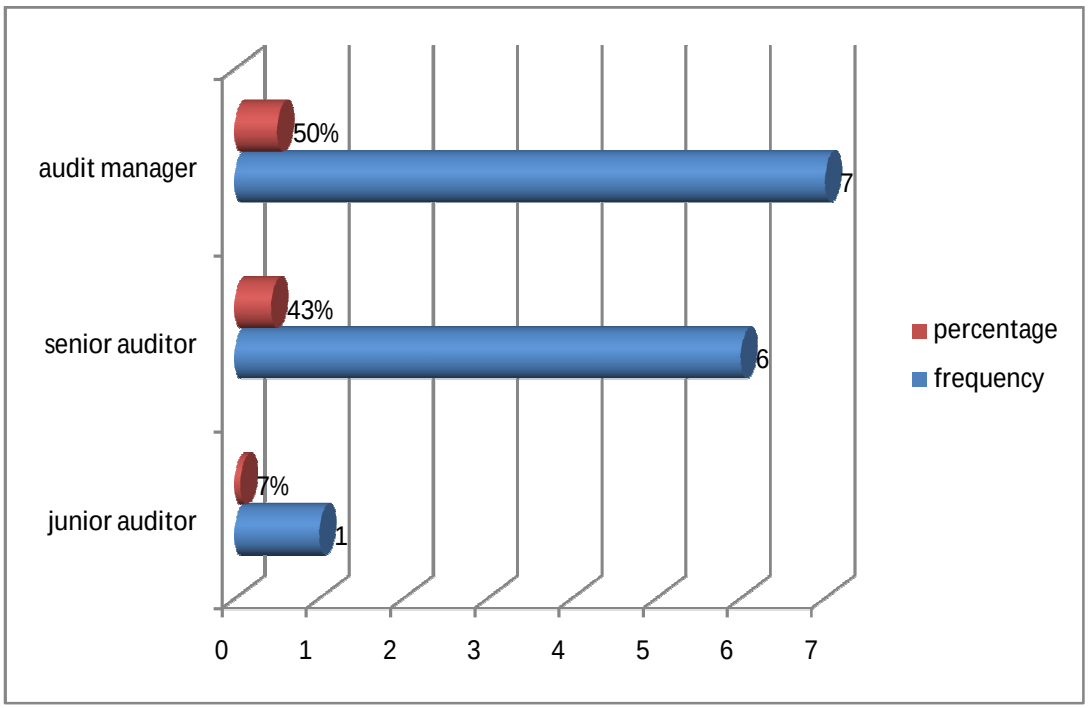


Figure 4 Position in firm.

Source Questioner survey 2014.

The researchers classify the respondents in terms of their position in an organizational structure of their particular organization, 50% audit managers, 43% senior auditors and 7% of the respondents were junior auditor. The majority of the respondents found in the highest ranks in the organizational structure of their audit firms in which they are in charges of designing an overall plan, supervise the junior auditors as at the field as well as finalizing the opinion of the audit team. These positions require relatively high qualification in terms of Education, Professional Certification & experience and this leads to conclude that auditors; in these positions are less exposed to the factors that affect auditors' independency.

3.2. Financial interest

	Frequency	Percentage
Yes	8	57%
No	6	43%
Total	14	100%

Figure 1. Do incentive made by clients to the auditor affect auditor's independency?

Source Questioner survey 2014

As it is seen from the above table, 8 of the respondents responded that incentives made by the client to the auditor will affect auditors' independency and 6 respondents replied that the above stated factor won't affect auditors' independency. Therefore the researchers conclude that the incentives made by clients to the auditor will affect auditors' independency.

	Frequency	Percentage
Yes	11	79%
No	3	21%
Total	14	100%

Figure 2 Does a threat from client staff members affect auditors' independency

Source Questioner survey 2014

When Auditors are in the engagement of an Audit, threats from clients' staff members on the Auditors can impair Auditors independency and this factor most of the time happens when client's staff members commit some illegal acts and 79% of the respondents as we can see from the following table stated that it's a factor that hinders Auditors independency.

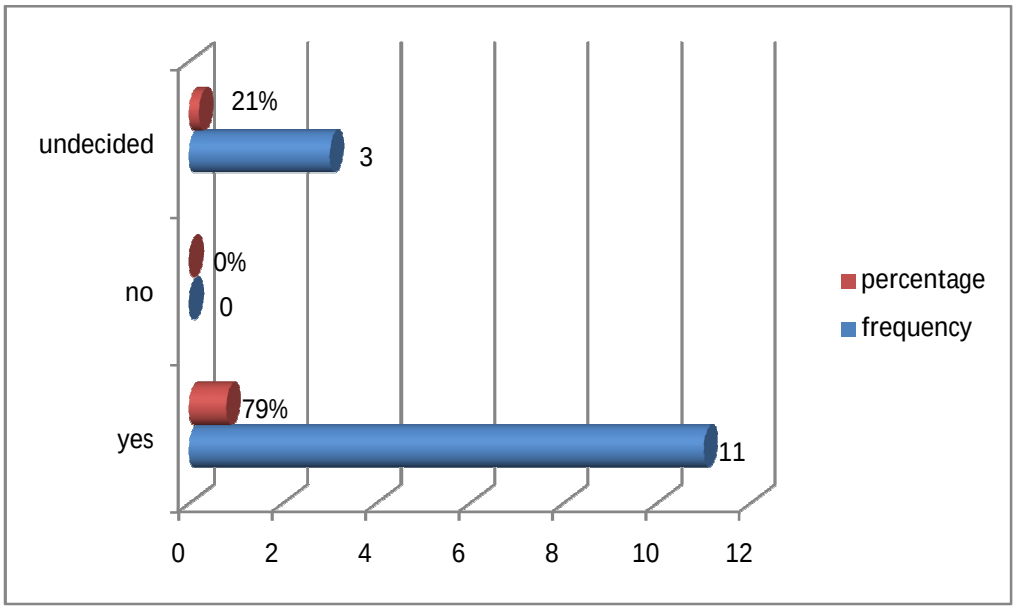
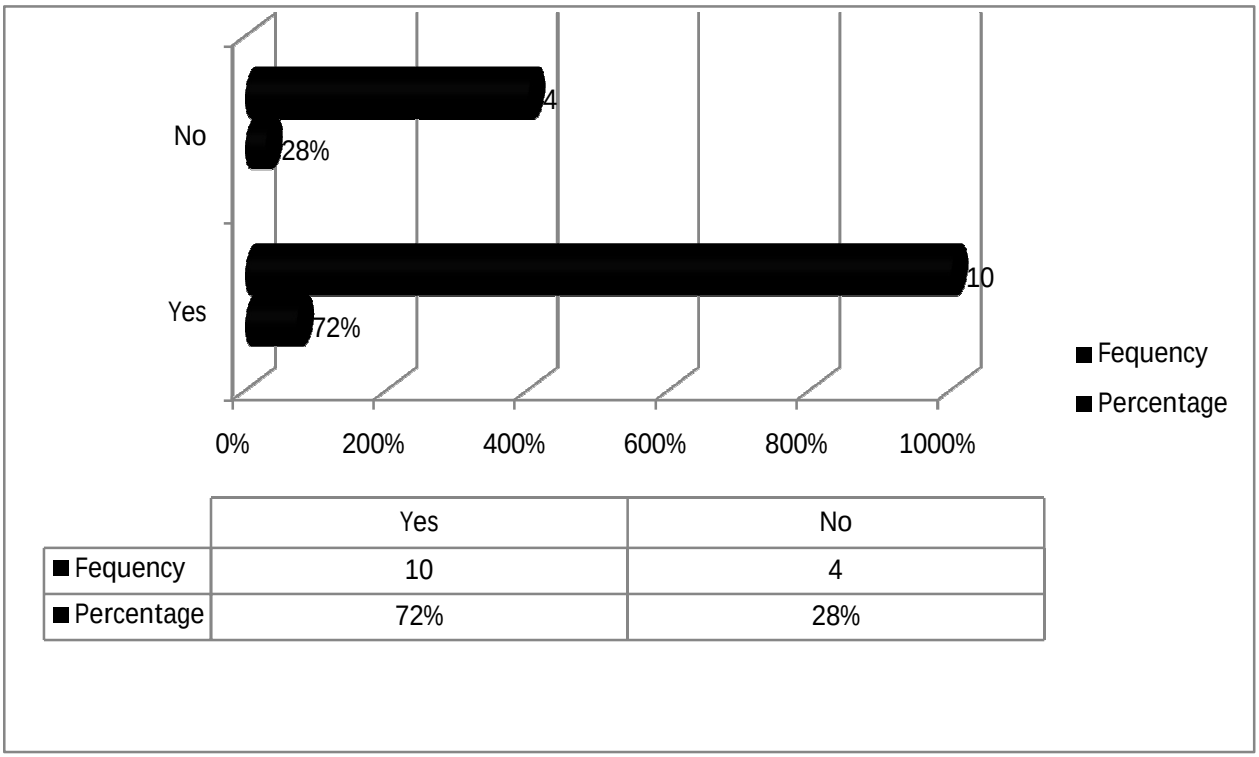


Figure 3 Effect of stock ownership on auditors' independency

Source Questioner survey 2014

From the above bar graph we see that 79% of the respondents replied financial interest which is having stock or investment in the client company affects the auditor independency and the rest respondents which is 21% did not decide. Therefore considering these the researchers conclude that ownership interest in the client company affects auditors' independency.

3.3. Bookkeeping and other services



	Yes	No
Fequency	10	4
Percentage	72%	28%

Figure 4 Do respondents' audit firms render non audit services to clients

Source Questioner survey 2014.

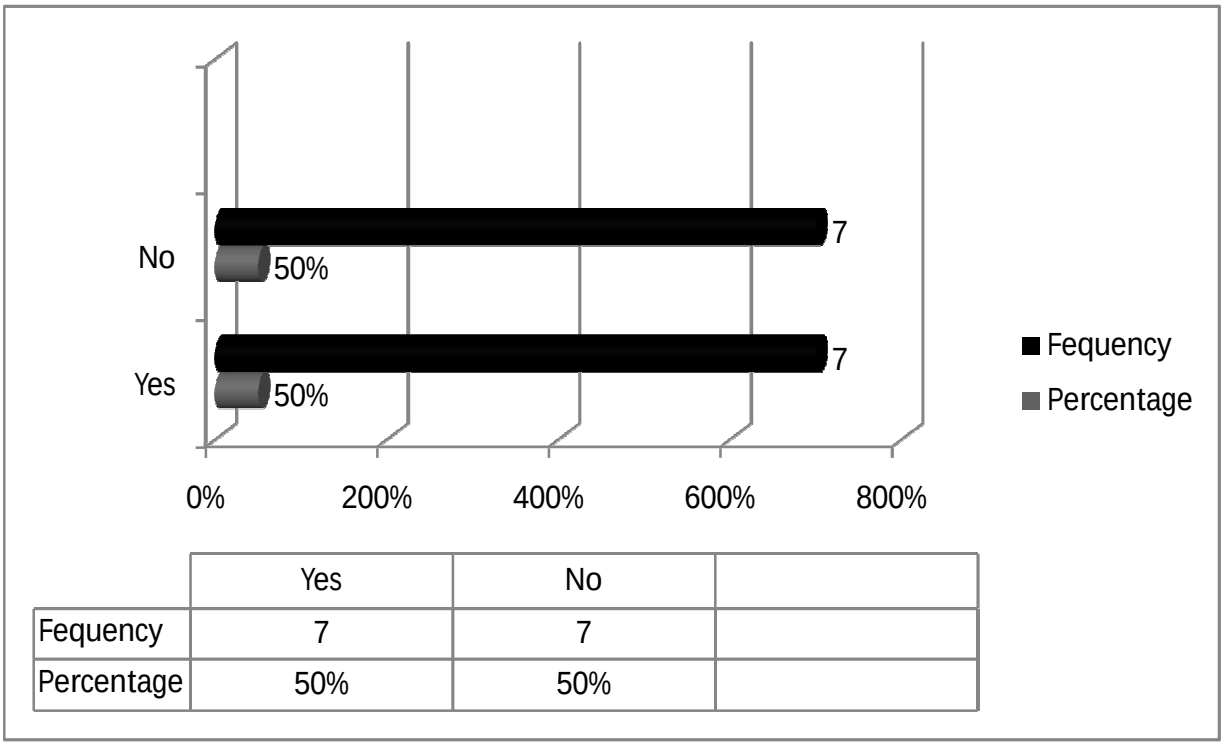
We can see that most of the respondents specifically 72% are giving non audit services to their audit clients and the remaining 28% or the respondents did not. And we can see in the next table what kind of non-audit services they are giving to decide whether it can affect their independency.

Response	Frequency Count	Percentage
Compilation	4	11%
Financial Statement Audit	2	5%
Management Consultancy	6	16%
Tax Planning & Reporting	5	14%
Internal audit support	5	14%
Accounting & support	5	14%
Accounting, reporting/Book keeping	8	22%
Information system related	1	3%
Total		100%

Figure 5 Types of non audit services performed by Audit Firms

Source Questioner survey 2014

The result in the above table showed that non audit services are mostly offered to clients whom the auditor is later expected to the fair and accurate presentation of the financial statement. These implies that when the audit firm performs these non-audit services to clients, the audit firm can be independent in the engagement of audit because the audit firm would try to provide assurance as to fair and accurate presentation of its own non audit services.



	Yes	No	
Fequency	7	7	
Percentage	50%	50%	

Figure 6 Effect of rendering non audit services on auditor's independence?

Source Questioner survey 2014.

To see how far auditors recognized the threat of non-audit service in their independence of conducting audit the researchers gathered the auditors' opinion whether they agree on this factor affect their independency or not. The above bar graph presents the response of the respondents. Even through half of the respondents did not agree on the effect of giving non audit services to audit client's affect auditors' independency.

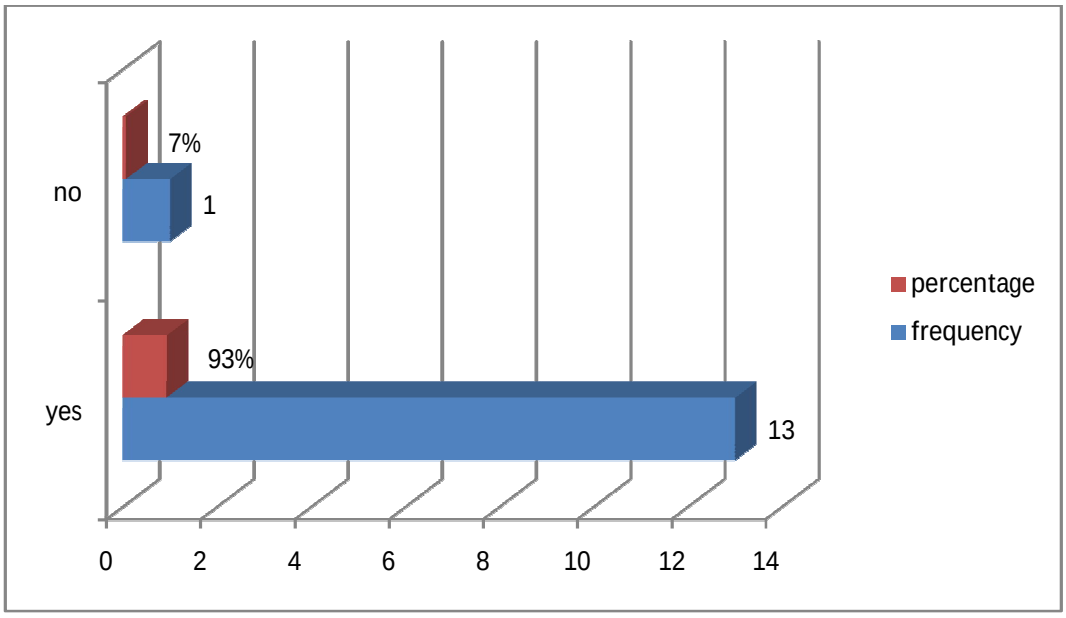


Figure 7 Effect of evaluating products for consecutive periods on auditors' independency?

Source Questioner survey 2014

In the engagement of an Audit, reviewing or evaluating products or judgments for consecutive period to the client is one of the main factor that hinders auditors' independency and about 93% of the respondents agreed on that. So that the researchers conclude that reviewing or evaluating products for consecutive period impairs auditor's independency.

3.4. Family relationship with the client

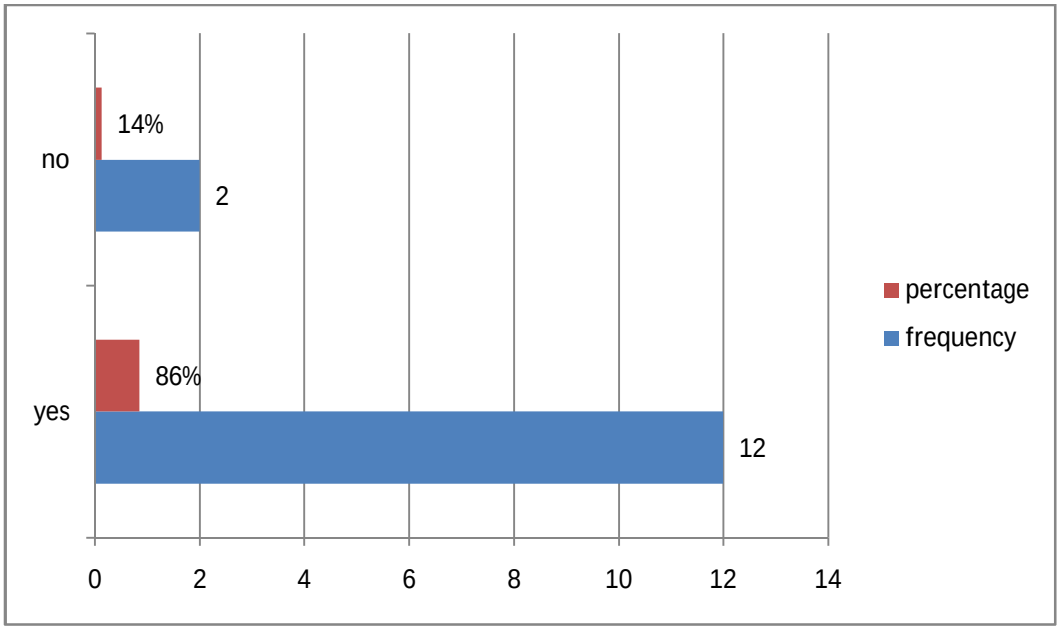


Figure 8 Effect of close relationship between auditor & audit clients in auditors' independency

Source Questioner survey 2014

In the engagement of Audit, the relationship between the Auditors and the clients is the main factor that impairs independency and it impairs independency and it impairs independency when the relationship gets very close then the independency of Auditors will be impaired, i.e. this close relationship makes the auditor to be sympathetic when assessing g the audit and 86% of the respondents have proven that this factor hinders Auditors independency. Therefore the researchers conclude that close relationship between auditor and audit client impairs auditors' independency.

3.5. Serving client company repeatedly

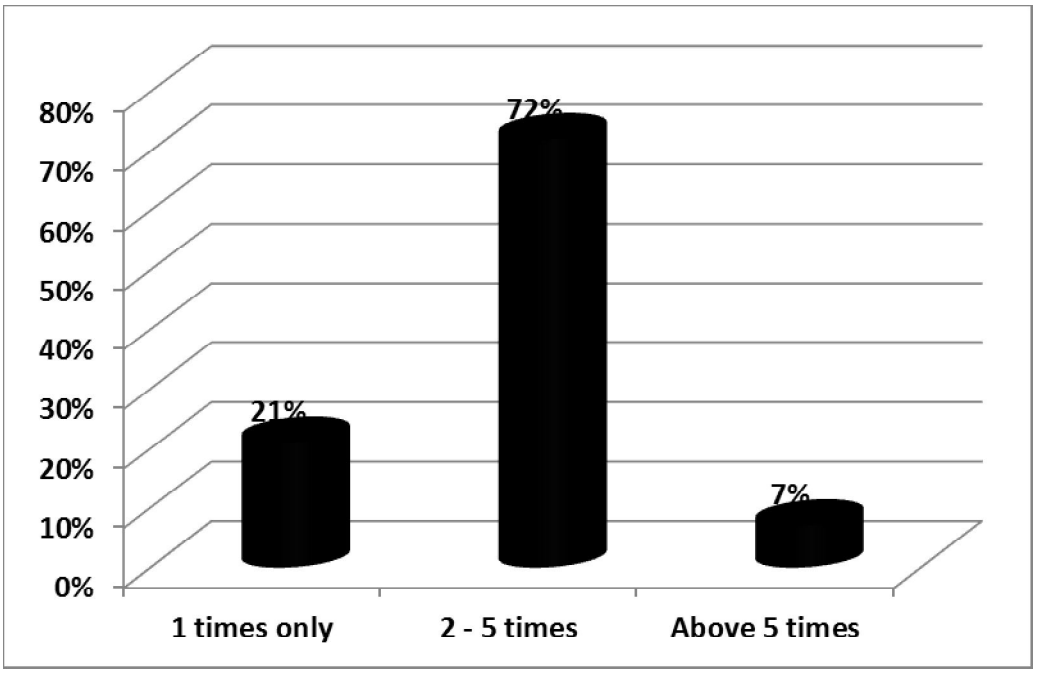


Figure 9 threats from long audit tenure to clients on auditor's independency

Source Questioner survey 2014

The above chart shows (21%) of respondents replied that they retain audit engagement to the same client 1 time only, but the remaining proportion (79%) of the respondents indicates that they give Audit engagement to the same client for more than 2 times and their factor or rendering audit service to the same client repeatedly impairs auditors independency as the frequency of rendering the service to the client repeatedly rises. Because they become familiar to the client company.

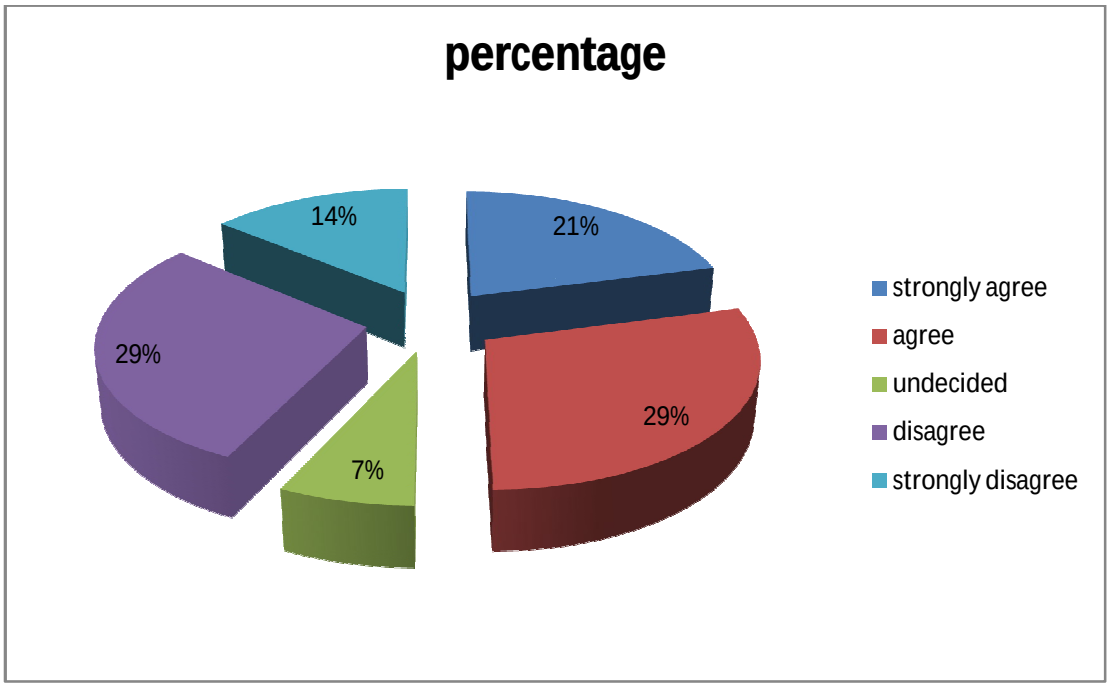


Figure 10 Effect of long audit tenure on auditor's independency

The pie chart presented above shows that respondents' opinion about the effect of long audit tenure on the auditors independency, and almost half of the respondents believed that their long audit tenure to the same client has impacted their independency and 43% of the remaining respondents decided that serving a client for a long period of time in audit profession doesn't have any effect of being independent & the remaining 7% of the respondents did not decide whether this factor affects their independency. Therefore one can infer that the effect of long audit tenure to clients' impair auditors' independency.

3.6. Others

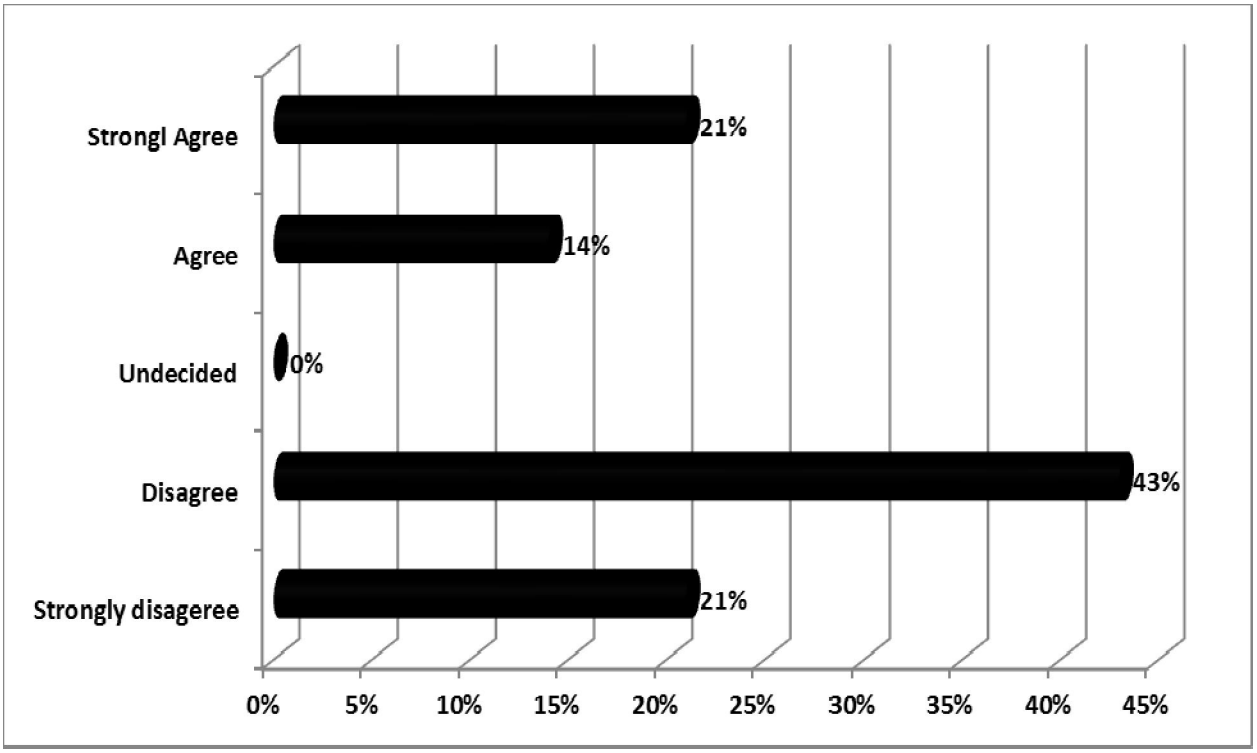


Figure 11. degree of competition in audit market

The above bar graph shows the responses of respondents' on the effect of degree of competition audit market on auditors' independency and 35% of the respondents replied that the above stated factors affects auditors' independency and the remaining 65% of the respondents stated that the factors won't affect the independency of auditors' from this point the researchers concluded that the degree of competition in audit market does not affect auditors independency.

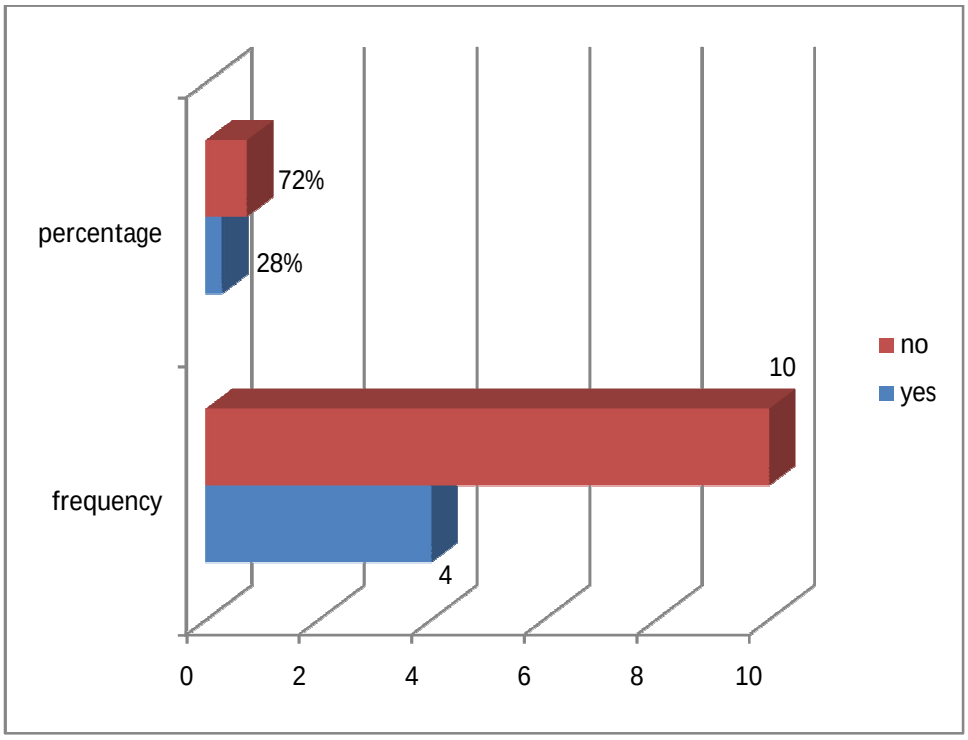
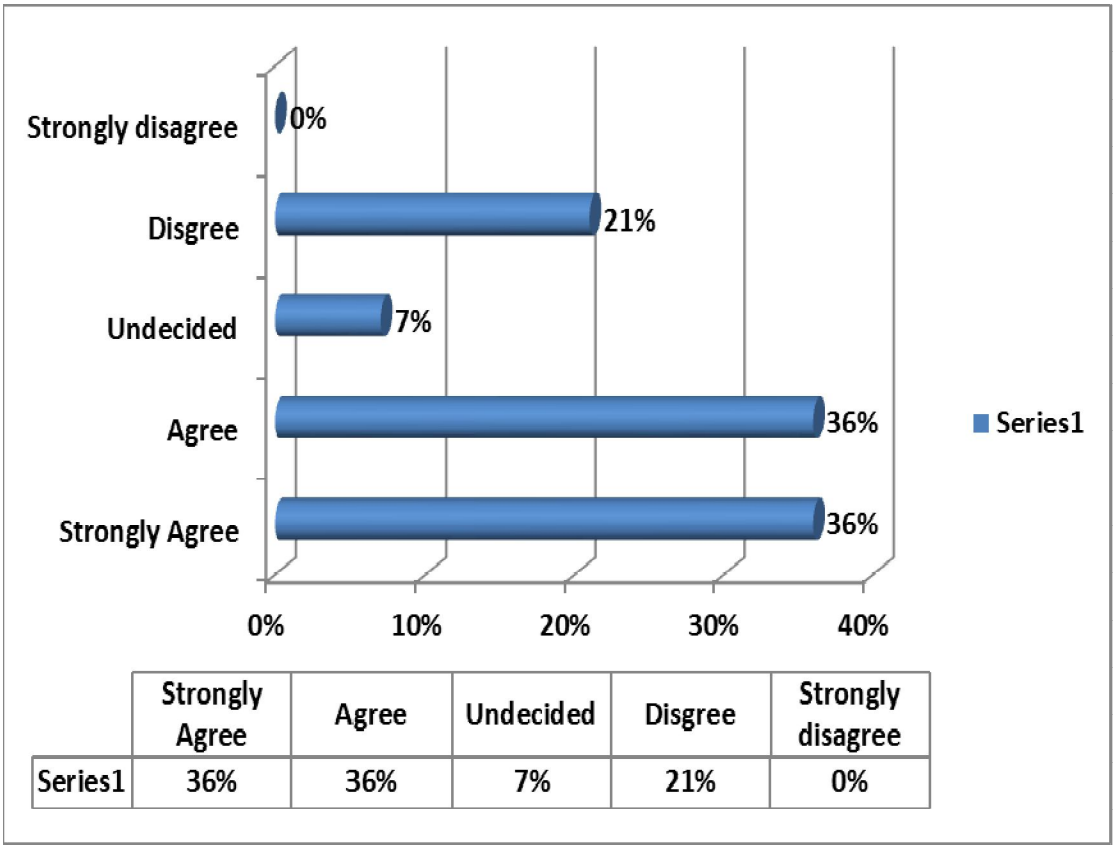


Figure 12. existence of audit committee in audit client

For the question asked whether there exists an audit committee in their organizational structure of the audit client, 4(28%) of the respondents answered “Yes” whereas the remaining 10(72%) answered “No”. The existence of audit committee can help avoiding the conflict of interest between external auditor and the management. Therefore the existence of audit committee is considered as favorable environment to the independence of the auditor.



	Strongly Agree	Agree	Undecided	Disgree	Strongly disagree
Series1	36%	36%	7%	21%	0%

Figure 13. Effect of audit committees on auditor's independency

When the researcher evaluate the results for the responses of auditors on the question on whether the existence of Audit Committee in audit clients will enhance auditors independency or not, 72% of the respondents have concluded that the existence of audit committee in audit clients' company will enhance auditor's independency, from the remaining respondents 21% of them issued that the existence of audit committee in the client's company won't enhance auditors' independency and remaining 7% of the respondents are not sure whether the existence or nonexistence of this committee have any impact on auditors independency . Therefore one can conclude that the existence of audit

committees' in client's organizational structure will enhance auditors' independency.

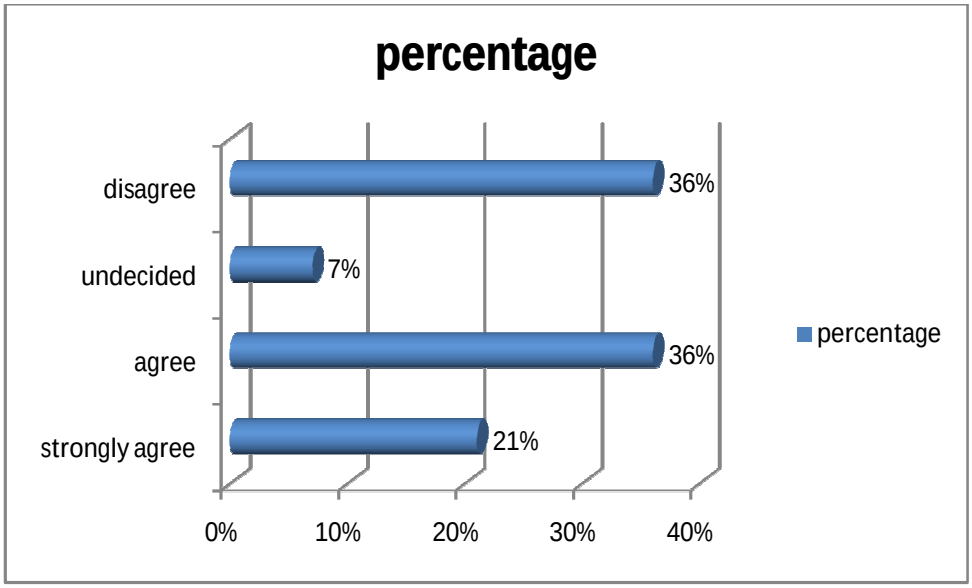


Figure14. Effect of hiring internal auditor by external auditors to perform most of the audit

The extent to which the internal auditor is given authority by the external auditor in the performance of audit is a factor that impairs the independency of auditors when the extent of authority gaps rises/increases. This factor hinders auditors' independency when the job of the external auditor mostly performed by the hired internal auditor, because as known internal auditors are not independent. 57% of the respondents agree that this factor hinders auditors independency, 36% of respondents stated that this factor won't affect auditors independency & the remaining 7% of the respondents are not sure whether this factor affects auditors independency or not. So the researchers concluded that the extent to which the internal auditor is given authority by the external auditor in the performance of audit affect auditors' independency.

	Frequency	Percentage
Yes	14	100%
No	0	0
Total	14	100%

Figure 15. Does Lack of integrity affect Auditors independency.

In audit profession, auditors lack of integrity or dishonest of auditors is the main factor for impairing their independency and as we can see from the above table, all of the respondents has agreed that this factor is the main factor that impairs Auditors independency . In the engagement of an audit, auditors should give a serious attention unless otherwise the audit opinion stated by this auditor cannot be said a fair opinion so in Audit profession auditors should give a due care in engaging audit profession. Therefore lack of integrity of auditors' in performing an audit hinders auditors' independency.

	Frequency	***Percentage***
Yes	12	86%
No	2	14%
Total	14	100%

Figure 16. Does auditors' negligence affect auditors' independency?

In the engagement of Audit, Auditors three types of negligence i.e. (simple negligence, gross negligence & fraud) are the main factors that hinder Auditors from being independent and 85% of respondents agreed that this factor impairs Auditors independency and the above table presents the responses of the respondents. From this point, the researchers infer that negligence in performing audit impairments auditors' independency.

	Frequency	Percentage
Yes	11	79%
No	3	21%
Total	14	100%

Figure17. Does a threat from client staff members affect auditors' independency?

When Auditors are in the engagement of an Audit, threats from clients' staff members on the Auditors can impair Auditors independency and this factor most of the time happens when client's staff members commit some illegal acts and about 79% of the respondents as we can see from the above table stated that it's a factor that hinders Auditors independency.

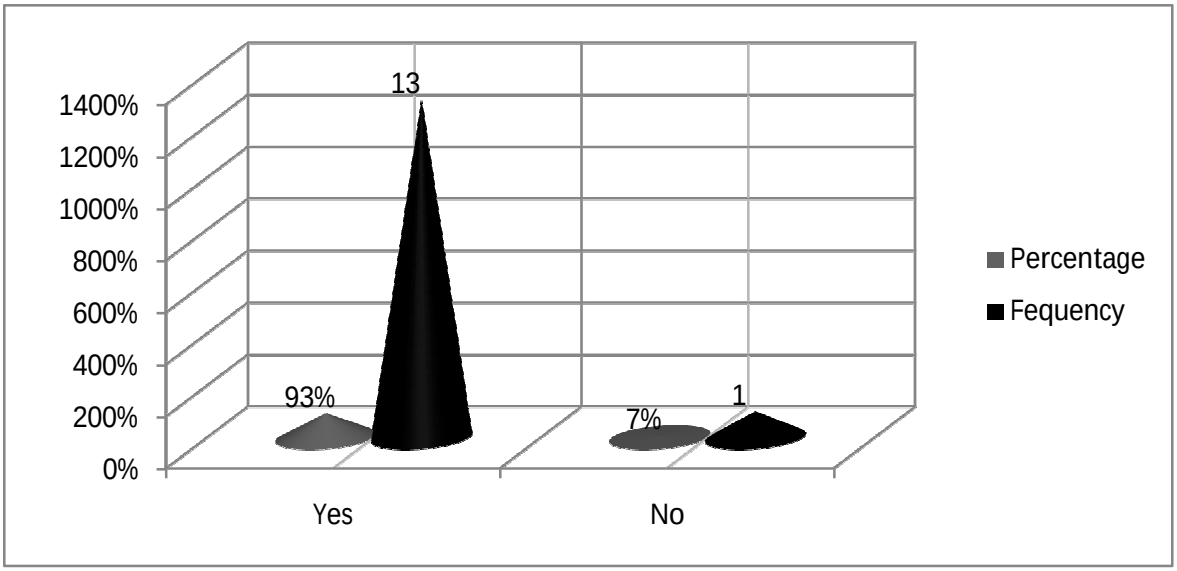


Figure 18. existence if quality control instrument in client companies'

Source Questioner survey 2014

It’s mandatory that Audit firms should have a “Quality Control Instrument” in which audit firms can measure their employees’ competence and independence through audit engagements and the above chart shows the responses of the respondents whether they have this instrument or not. The chart shows 93% of the respondents replied that there is a quality control instrument in their audit firm. The researchers conclude that having a quality control instrument in audit firms’ will enhance auditors’ independency because it allows audit managers to evaluate their staff members’ competence and degree of independency.

Chapter four

4. Summary, Conclusion and Recommendation

4.1. Summary of findings

This chapter summarizes the main findings of the study and present conclusion and recommendations to the identified factors based on the conclusion.

The study indicates that having well-trained, qualified and also experienced staff members in audit firm will enhance auditors' independency. Also having a senior auditors' and experienced audit managers in audit firms enhance staff members independency and these positions require relatively high qualification in terms of education, professional certification and experience and this leads to conclude that auditors in these positions are less exposed to the factors that affect auditors' independency.

According to the study incentives made by client staff members to the auditor affect auditors' independency. And 57% of the respondents agreed on that.

When auditors are in the engagement of an audit, threats from clients' staff members to the auditors can impair auditors' independency. 79% of the respondents agreed and this factor most of the time happens when clients' staff members commit some illegal acts.

However 21% of the respondents did not decide auditors' stock ownership in clients' company affects auditors' independency. And it is proven by the majority of respondents which is 79%.

Even though half of the respondents did not agree on the effect of non-audit services on auditors' independency, the researchers concluded that rendering non audit services to clients' affect auditors' independency.

Reviewing or evaluating products for consecutive periods to clients hinders auditors' independency. About 93% of the respondents agreed on this factor.

Rendering Audit service to the same client repeatedly impairs auditors independency as the frequency of rendering the service to the client repeatedly rise.

In the engagement of audit, the relationship between the Auditors and the clients is the main factor that impairs Auditors independency and it impairs independency when the relationship gets very close then the independency of auditor will be impaired, i.e. close relationship makes the auditor to sympatric when assessing the audit and about 86% of the respondents have proven that this factor hinders Auditors independency.

Half of the respondents agreed on the factor of long audit service to the same client, 43% disagree and the remaining 7% of the respondents undecided. Therefore researchers conclude that the effect of long audit tenure to clients' impairs auditors' independency.

The competition in audit marker is considered as one factor which affects auditors' independence, but the researchers have concluded that this factor will not affect auditors' independency because the majority respondents disagree which is 64%.

The researchers conclude that the existence of Audit Committees' in clients' organizational structure will enhance auditors' independency. And it is proven by 72% of the respondents.

However 7% of the respondents undecided, 36% disagree, the researchers conclude that the extent to which the internal auditor is given authority by the external auditor in the performance of audit affect auditors' independency because the remaining 57% of the respondents agreed.

All respondents agreed that lack of integrity of auditors' in performing an audit hinders auditors' independency.

According to the study negligence in performing audit impairs auditors' independency and 86% of the respondents agreed.

The study indicates that having a quality control instrument in audit firms' will enhance auditors' independency because it allows auditor managers to evaluate their staff members' degree of independency. And it is proved by the respondents by 93%.

4.2. Conclusion

On the basis of major findings resulted from the analysis the researchers made the following conclusions in a way that the major research questions are answered.

The external audit service in Addis Ababa Ethiopia is conducted by 71 privet audit firms who are authorized by the office of audit general (OFAG). The study conducted on sample audit firms to assess the independency of external auditors in their audit practice. Auditors' professional as well as legal requirement in the conduct of audit was considered the focus of the study as the public trust on the quality of audit report depends on auditors' competence. Competence of auditors' was measured in terms of education, professional development, experience as well as rank of the auditors and the findings in this respect leads to conclude that audit in Ethiopian audit firms context is conducted by competent professional and the experience showed that the result is in line with local and international requirement. At international and national standards accountant in public accounting services including auditors' are required to have at least a bachelor degree, and also to have a certification of authoritative professional bodies in accounting as well as to have a relevant working experience in the profession of public accounting service and the results in this respect is remarkable.

The distribution of auditors in the different hierarchical level in an audit firm's organizational structure also showed a result that can go in line with the competence with the auditors in that the proportion of auditors' qualification.

This study analyze concerning on factors that affect auditors independency such findings from the respondents have proven that these factors affect auditors independency. Respondents have been proven that incentives made by the staff members to the auditor will affect auditors' independency, and respondents have proven that one of the factor that is the extent to which the internal auditor given by the external auditor to perform an audit will affect auditors' independency, negligence of the auditors in performing an audit is proven by the respondents that it affects auditors' independency.

The privet audit firms market in Ethiopia is identified by practicing professional accountants and auditors as highly competitive and as the respondents' opinion; it is learned that competition in the audit market has not been challenging auditors to remain independent.

4.3. Recommendation

Based on the results of the study and conclusion of relevant theoretical literature as to the possible solutions of identified problems the following points are forwarded as a recommendation.

- The management of audit firms are advised to pave ways in which the large ACCA student population in their respective firms to become graduate and keep on taking part in the professional development as well as putting the involvement in professional development to work as a stuff o audit firm.
- Auditors' in the engagement of audit practice must strictly follow professional as well as legal requirement made to maintain the auditors' independence and other fundamental requirements having implication on public confidence and /or overall auditor quality.

- Auditors must strictly follow the requirements and decide on the nature and type of organization on which offering audit and services other than audit.
- Assigning different person on working group to make on check the work of the other instead of letting one to audit his/her own to defend auditors' independence from a few review threats. Assigning different engagements as well as for repeated audit engagement can also encourage as it can also help the audit firm to reduce the danger of familiarity create resulted from friendly and long relationship between audit staff and client employees and /or management.

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ST. Mary University

Department of Accounting & Finance.

Dear respondents

This questionnaire is prepared for gathering data for the accomplishment of senior essay on B.A degree in Accounting and Finance. The researcher wants to assure you that this research is only for academic purpose. And your ideas and comments are highly honored and kept safe for academic purpose only. Therefore it will not be disclosed to any outsider without your consent. The researcher will like to express their thanks in advance to all respondents.

General Instruction

Please answer the following questions that are followed by choices and tick your answer from the choices. If you have any additional comment or ideas feel to use blank paper.

I. Personal Information of respondent

1. Educational Qualification
    a. Diploma in Accounting
    b. BA Degree in Accounting
    c. Masters (MSC) & Above

2. Professional body affiliation
    a. ACCA Student
    b. ACCA Certified
    c. CPA Student
    d. CPA Certified

e. CIA Certified
f. Other (Please specify _____)
g. Note affiliated

3. How long you have been in Audit Profession?

_____

4. What is your position in your firm?

a. Junior Auditor
b. Senior Auditor
c. Audit Manager
d. Other (Please specify _____

II. Financial interest

1. Do you think incentives made by the staff members of client's company to the auditor will impair the auditor's independency?
   a. Yes b. No
2. Do you agree that auditors independency is impaired when the Auditor is on the engagement team could benefit in some way or form (For example Financial) with client?
   a. Yes b. No c. Undecided
3. Do you propose that auditor's ownership interest in the clients company will affect auditor's independency?
   a. Yes b. No

III. Bookkeeping and other services

4. Have you ever offered non audit service to audit client?
   a. Yes b. No

5. If you answer for question 4 above yes, which type of service you offered to the clients
    a. Compilation
    b. Financial Statement review
    c. Management Consultancy
    d. Tax Planning and reporting
    e. Internal audit supporting
    f. Accounting & reporting/book keeping
    g. Information system related
    h. If any please specify_____
6. Do you think that performing the above non audit services for the client will affect auditors independency?
    a. Yes b. No

7. Do you think that auditors independency will be impaired if the auditor is hired to review/evaluate and product or judgments that they themselves were responsible for preparing (from previous engagement) in order to reach a conclusion?
    a. Yes b. No c. Undecided

IV. Family relationship with the client

8. Do you agree that Auditors independency is impaired if the Auditor has some form of close relationship with the client which may cause them to be generous and systematic when assessing the client?
    a. Yes b. No c. Undecided

V. Serving client company repeatedly

9. How many times you have audited the same client from year to year?
    a. 1 times only
    b. 2 – 5 times

c. Above 5 times

10. Do you think that performing audit service repeatedly to the same client will affect the independency of the auditors?
    a. Strongly agree
    b. Agree
    c. Undecided
    d. Disagree
    e. Strongly disagree

VI. Others

11. In your opinion that the level of competition in the Audit market affect your capacity of being independent.
    a. Strongly agree
    b. Agree
    c. Undecided
    d. Disagree
    e. Strongly disagree

12. Is Audit committee exits in most client organizations?
    a. Yes b. No

13. Do you think that the existence of audit committee in the client company will enhance Auditors independency?
    a. Strongly agree
    b. Agree
    c. Undecided
    d. Disagree
    e. Strongly disagree

14. To what extent that Auditors independency is impaired if the external auditor hired internal auditor and let the internal auditors to perform most of the audit?
    a. Strongly agree
    b. Agree
    c. Undecided
    d. Disagree
    e. Strongly disagree

15. Do you think that lack of integrity of auditors will affect the auditor's independency?

a. Yes b. No

16. Dou you think that auditor's negligence in performing audit will affect auditor's independency?

a. Yes b. No

17. Do you agree that auditors independency will be impaired if the auditor is deterred from acting in an objective, professional manner as a result of threats of the client?

a. Yes b. No c. Undecided

18. In your audit firm is there any quality control instrument with which your employee can be measured as competent and independent?

a. Yes b. No