



ST.MARY'S UNIVERISTY
SCHOOL OF GRADUATE STUDIES

PROVISION OF NON AUDIT SERVICE TO THE AUDIT
CLIENT AND AUDITORS INDEPENDENCY AND AUDIT
QUALITY

BY
SEBLE BZUNEH G/MARIAM

DECEMBER, 2016
ADDIS ABABA, ETHIOPIA



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DECLARATION

I undersigned declare that this thesis is my original work, prepared under guidance of Abebaw Kassie (PHD). All sources of material used for thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to other higher learning institution for the purpose of earning any degree.

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DECEMBER, 2016

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval a university advisor.

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DECEMBER, 2016

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Abstract

The independence of an auditor and maintaining audit quality has not only been viewed as an ethical issue within the auditing professional bodies like the International Federation of Accountants (IFAC), but also it is the cornerstone, which a successful audit is based. This paper examines whether provision of non-audit service to an audit client affects audit independency and quality. A questionnaire was used to collect data from seventy employees of ten private audit firms located in Addis Ababa. The responses obtained were analyzed using a quantitative and a qualitative approach with the help of SPSS. The researcher used purposive sampling technique, and the study had seventy-four total audit firms in the industry. In relation to the provision of non-audit service on auditor independency and audit quality the result shows that, the provision of NAS to audit clients was found to provide auditors with greater experience of the client's industry and greater access to the client's accounting system. Additionally, such an arrangement was considered to enhance audit quality, but simultaneously it was also believed that a separation of engagement teams, which carries out NAS from audit services, was desirable since auditors are perceived to have greater credibility when the demarcation is clear. The study recommended Accounting and Auditing board of Ethiopia should properly scrutinize the work of private audit firms concerning NAS, provide continuous trainings, and establish upgraded set of guideline based on the best practices.

Key Words: Non audit services, Auditor independence and Audit quality

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Acronyms & Abbreviations

ACCA:	Association of Chartered Certified Accountants
AABE:	The Accounting and Auditing Board of Ethiopia
AICPA:	American Institute of Certified Public Accountants
CPA:	Certified Public Accountants
ECSAFA:	Eastern, Central, and Southern African Federation of Accountants
ECSU:	Ethiopian Civil Service University
EPAAA:	Ethiopian Professional Association of Accountants and Auditors
GAAS:	Generally Accepted Auditing Standards
IAASB:	International Auditing and Assurance Standard Board
IESBA:	International Ethical Standard Board of Accountants
IFAC:	International Federation of Accountants
IFRS:	International Financial Reporting Standards
ISB:	Independence Standard Board
NAS:	Non-Audit Service
NGO:	Non-governmental Organization
OFAG:	Office of the Federal Auditor General
SME :	Small and Medium Enterprises
US.SEC:	United States Security Exchange Commission

CHAPTER ONE

1.1 Background of the Study

The audit firms have a major demand to be able to provide several services besides the audit to their clients (SOU, 1999: Tanewski& Carey, 2007). Companies that seek an audit do not only require an audit opinion on their financial statements but also a range of services.

Non Audit service may include consulting service such as system design, compliance related service, such as taxation, and accounting advice, and assurance related service, such as deligence.(Abdel-Khalik, 1990).

When an auditor does an audit report and they find errors, they make notes to the company with matters that have to be fixed in order for the auditor to give a "green light" on the audited company's financial statement (Arrunada, 1999). It is at this point that non-audit services are essential for the audit firm as well as the audited company, since the company may need help from the professionals, the audit firm, to be able to meet up with the requirements that the audit notes requires (Elliot & Pallais, 1997). The audit firms on the market are therefore offering their clients a package deal consisting of non-audit services and the final audit opinion, since the market is asking for it (Arrunada, 1999).

When it comes to the non-audit services there are restrictions of how they can be performed, there has to be a strict separations of the employees that do the audit and the ones that do the non-audit services. The restrictions tell us what an auditor is allowed to do, which is only to give an audit opinion without any further help whatsoever when it comes to how to manage the errors the auditor discovers Federal Acquisition Regulation(FAR, 2012). The reason for this

separation is that the auditor has to be independent in all situations while performing the audit. YeCarson and Simnett(2006) suggest that the economic dependence of auditors on non-audit services, lengthy audit tenure and personal relationships built through employees have contributed to the erosion of auditor independence.

The concept of audit independence is fuzzy, the rules governing it are complex and burdensome, and a re-examination is long overdue (Elliott and Jacobson, 1992).DeAngelo (1981) defined auditor independence as "the conditioner probability of reporting a discovered bridge". Arens et al. (1999) defined "independence in auditing" as taking an unbiased viewpoint in the performance of audit tests, the evaluations of the results and the issuance of audit reports. Independence includes the qualities of integrity, objectivity and impartiality.

The US Government Accountability Office ("GAO") (2015: 10) "A quality audit is an audit conducted in accordance with generally accepted auditing standards (GAAS) to provide reasonable assurance that the audited financial statements and related disclosures are (1) presented in conformity with GAAP and (2) are not materially misstated whether due to errors or fraud".

1.2. Statement of the Problem

In recent years some auditors practicing non-audit services; therefore, the main question that arises when auditors provide or could provide both audit and non-audit services is whether the auditors are able to conduct their audits impartially, without being concerned about losing or failing to gain additional services, and the subsequent economic implications for the audit firm (Lee, 1993).

The provision of NAS which both adds value to the client and provides the auditor with the essential understanding of the mode and nature of the client's activities, an understanding which will underpin the audit opinion. Such a viewpoint fitted comfortably within the portrayal of business risk audit as a value-adding activity situated within the client's overall risk management strategy, with a focus on the overall control and corporate governance environment, knowledge of the business and a key assessment of management integrity (Lemon et al., 2000), and also within the framework of assurance services and consulting as a continuum with few defining break points (Jeppesen, 1998; Borit and Cockburn, 1998). On the contrary, others argue that the negative impact of independency impairment and quality compromising outweigh the benefits. The provision of non-assurance services may create threats to the independence of the firm or the members of the assurance team, particularly with respect to perceived threats to independence (like advocacy, familiarity, intimidation, and self-review).

Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases, it may be possible to eliminate or reduce the threat created by application of safeguards. In Enron, the fact that Andersen provided extensive NAS relating to the setting up of a number of the key off-balance-sheet vehicles, which were used to manipulate the financial statements, clearly provided them with knowledge of the relevant transactions—but in the end, this did not lead to a higher quality audit (Bartlett, 1993).

In the context of Ethiopia, provision of both audit and no-audit services are allowed to be practiced by audit firms existed in the country (OFAG, Ethical code, 2009, p33-40). Moreover, they compelled by the Office of Auditor General to put in place appropriate mitigation or safeguarding mechanisms to deal with threats or risks that will be encountered in connection with provision both audit and non-audit service to audit client.

Even though the provision of non-audit service to audit clients is not grown well in Ethiopian situation compared with the global practices(World Bank 2007 and Mihret 2011), it is sound and imperative to examine the prevailing situation in light of the, presence of International Accounting, Auditing and Consulting firms through affiliated correspondence local firms, existing country capacity in attracting foreign direct Investments(The Presence of Multinational Companies), and the existence of two wings or arms (consultancy and Auditing) in most external audit firms, even, which are organized at individual level.

Moreover, as per the Ethiopian Financial Infrastructure review undertook by the world Bank (2007), the Ethiopian private audit services is in full of problems, issues like lack of tailored Accounting standards in line with the country context, inconsistency of financial statements being audited by the audit firms and standards referred, bases of audit fees, professional ethics, lack of quality assurance mechanisms by the regulatory organs, etc. The above-mentioned issues are also replicated in NAS, the problems are exacerbated due to overlapping mandates in licensing the consultancy and audit services, and supervisory activities, and weak regulatory oversight, (World Bank 2007)trigger the researcher to assess the existing problem.

1.3. Research Questions

Rq1.How provisions of non-audit services affect audit quality and independency of the auditor?

Rq2.What are the audit threats that arise in the course of provision of NAS to audit client?

Rq3. What are the proxy or surrogate measures of audit quality and independency?

1.4. Objectives of the study

4.1.1. General Objective

The general objective of this study is to assess the relationship between provision of non-audit services to audit clients and audit quality and independency of the auditors.

4.1.2. Specific Objectives

- ❖ To assess the relationship of Provision of NAS and audit quality and independence.
- ❖ To examine varies type of threats to auditor independence and audit quality in relation with provision of non-audit service.
- ❖ To examine the existence of safeguarding mechanisms in the audit firms designed to curtail impairment of independency and compromising of audit quality.

1.5. Significance of the study

This research is very essential to show provision of non-audit service to an audit client relationship on auditor's independence and audit quality, from practitioner auditor's perspective. In addition this research is important for future researchers as a reference material to develop a literature framework.

1.6. Limitation of the Study

The researcher has encountered time and budget constraints to carry out the research because number of private Audit firms (geographically) and respondents were working in the client's office, in fields, and attending ACCA

studies, therefore the respondents weren't responding within expected time for the researcher to perform the sorting, coding, testing and analyzing processes.

1.7. Definition of term

Independence

The Independence Standard Board (ISB, 2000) defines independence as: Freedom from pressures and other factors that impair, or are perceived to impair, an auditor's willingness to exercise objectivity and integrity when performing an audit is the absence of certain activities and relationships that may impair, or may be perceived to impair, an auditor's willingness to exercise objectivity and integrity when performing an audit. Resist client pressure.

Audit Quality

Arenset. Al (2011: 105) Audit quality means how well an audit detects and report material misstatements in financial statements, the detection aspects are a reflection of auditor competence, while reporting is a reflection of ethics or auditor integrity, particularly independence.

1.8. Organization of the study

The study has five subsequent chapters. The first chapter background of the study, statement of the problem, objective of the study, significant of the study, and the scope of the study. The second chapter describes the review of related literatures. The third chapter was discussed research design and methodology. The fourth chapter is analysis, discussions and presentation part of the research findings, and the last chapter; chapter five presents summary and conclusions and recommendation; followed by the list of references used.

CHAPTER TWO

Literature Review

Introduction

This chapter presents the literature review and tries to relate the existing literatures to this study. The main essence of this chapter is to enable readers“ get a grasp of what is already known within the area of study. It mainly focuses on the review of both the theoretical and empirical evidence on the impact of provision of NAS to audit client on auditor’s independency and audit quality.

This chapter is organized in to three sections. The first section deals with theoretical underpinning in connection with provision of non-audit service, audit quality, auditor independency, different types of threats that impair auditor independency, and safeguarding mechanisms that can be applied for different types of threats. The second section deals with empirical studies regarding NAS from the extant literature.

2.1 Theoretical review

This section tried to involved various theoretical insights or overviews related with the impact of provision of non audit service to an audit client. In order to relate various theories with this study, the researcher tried to explore varieties of theoretical issues from different authors.

2.1.1 Non-Audit Service

Non-audit services that the audit firms provide encompasses besides traditional consulting in the field of accounting and tax issues, also includes consulting/advisory within for example business analysis, business development, financial analysis, valuation of company, IT, investments, strategic planning, HR, Installation and implementation of software and

hardware and outsourcing of the internal account functions (Elliot & Pallais, 1997). This service can be provided by the incumbent audit firm or another audit firms. Non-audit services constitute the source of non-audit income. The level and range of non-audit services (NAS) being provided by audit firms to their audit clients has increased greatly over the last few years. It is reported that in larger firms, non-audit fees now exceed the fees received from audit work; in fact many firms have re-branded themselves as professional service providers rather than audit or accounting firms (Beattie & Fearnley, 1999).

The motive for accountants and auditors to provide their services under the same component is because they want to complement each other's work and being able to provide their clients a package solution, (Arrunada, 1999). The difference between a consultant and an advisor from an auditor is mainly that a consultant can give the entity recommendation and assistance to enhance the quality of the financial statements.

Unlike the auditors, limited duties the consultant and the advisors work is not that restricted or scrutinized by the law, and there is no demand by law to use their services (Abdel-Khalik, 1990). The audit profession has matured over the years and the audit is under intense competition which has decreased their profit (Beattie et al., 1999). Because of this, it has become more of a rule than an exception to offer the audit clients a variety of services that extends considerably longer than the traditional auditing (SOU, 1999:43; Tanewski & Carey, 2007).

There is a need from the clients that the audit firm also provides non-audit services. The benefit to the audit firm is that a combination of audit services and non-audit services is cost effective in the matter that they can use the same information and knowledge in the audit as well as the consultancy assignment (Arrunada, 1999).

Another benefit for the client with this joint service provision (audit and non – audit) is that they can also take part of the audit firm's competence, especially

in the field of the economic area. There has been suggestions that smaller clients/companies have a fundamental need of non-audit services since they don't have the same possibilities to perform this kind of activities unlikely bigger companies, since they do not have the same possibilities to hire staff or employees for those kind of duties (Johannisson & Lindmark, 1996; Tanewski& Carey, 2007). An important benefit seen from the audit firms perspective is the fact that by providing non-audit services, the knowledge of the audited company is much less time consuming since they don't have to spend that much time to understand the audited entities connection with the non-audit services (Johan Olsson & Christian Ottoson,2013).

However, Bennet & Robson (1999a) argue that consulting and advisory is important for the company, but it is not life or death for the company's development. Even though companies utilize non-audit services frequently, they do not consider non-audit services to have a significant impact on the company (Bennet & Robson, 1999a). However, there is a risk that the consultant/advisor from the audit firm acts in a strong stake rather than the clients interests' (Bloch, 1999).

Auditors and consultants role in smaller companies have been suggested to be manipulated towards an increased use of the audit firm's services (Gibb, 2000).

A possible risk could be that the consultant/advisor in advance chose several specific areas to focus on and that the consulting/advisory is not adjusted to the company's actual needs. Instead they point towards leveraging the profit for the audit firm (Mole, 2002). While the consultant and the advisors duties are quite holistic and transparent, it is still the auditors opinion that is final for the company's financial statements, but what does the auditor do to get there? The mystery of the auditor .The company's stakeholders demand assurance before they are about to do any sort of business with them. It's at this point the auditor appears, like a "ritual priest" he manifests and waves with his magic wand, and the company is "clean" (Pentland, 1993).

Several academics strive to find an answer to why we need auditors and to what they exactly produce (Power, 2002).

According to Power (2002) suggests that an auditor produces paper, and a lot of it. The auditors themselves do not really produce anything new in the form brand new product. Instead they make their signature that the output that the company themselves has produced is fairly stated in all material elements. However, for the auditor to make sure that of this the audit obtains impartial evidence as Power (2003) says.

Moreover, according to (Craswell, 1999), the problem with these non-audit services that is seen by some is that the audit firms have an incentive to keep a client for which they provide audit services, because they also receive non-audit service fees from this client. As a way to overcome this issue, the Securities and Exchange Commission (SEC) United States, suggested the disclosure of NAS fees. They contended that the disclosure related to non-audit service fees (NAS) received by auditors would give investors insight into the relationship between a company and its auditor. In addition, they argued that the disclosure will reduce uncertainty about the scope of the relationships by providing facts about the magnitude of non-audit service fees.



Theoretical Concepts Used in Prior Research of Non-Audit Services

As is also evident from the literature review, prior research on non-audit services focuses on their effects on different measures of audit quality, which again can be affected by auditor independence concerns, or knowledge spillovers that affect auditor competence. The approach of this paper focuses on the effects of providing non-audit services to audit client on auditor's independence and audit quality.

2.1.2 Audit practice in Ethiopia

Government auditing in Ethiopia dates back the early 1931 constitution, which stressed the importance of the proper collection of the state revenue and the necessity of procedures to control expenditures but stopped short of either referring to or requiring any audit as such. This, in fact, had to wait for proclamation 69 of 1944, which established the Commission for Audit, which was largely responsible for the examination and control of the accounts of the

Ministry of Finance and was directly accountable to the Prime Minister. (Yohannes,1990).

According to Yohannes, the modern accounting in Ethiopia started during the 1900 Emperor Menelik established Finance and treasury ministry, which was to keep records of the King's treasury. The other issues is the development of public accounting in Ethiopian, begins when the British accounting firms like Price Waterhouse Peat & Co., established their branches in the Ethiopia around 1940(YohannesKinfu, 1990).

In 1946, proclamation No. 79/1946 was provided to centralize the audit and control of all Government accounts in one department by establishing the audit and control office under the direction of the comptroller and Auditor General who reported and was directly responsible to the Prime Minister (OFAG, 2008).

Senait (2003) mentioned that, Articles 120 and 121 of the revised constitution of 1955 clearly conferred the rights and duties of auditing all ministries, departments, and agencies to the Auditor General, whose office was then established as a separate, independent entity that reported directly to the Emperor and to Parliament. These articles demands the Auditor General to submit periodic reports to the Emperor and to Parliament on the financial operations of the government, and entitled the Auditor General to access all books and records pertaining to government accounts.

Subsequently, the functions of the Auditor General were amended by decree No. 32 of 1958, which was later renumbered as proclamation No. 179/1961 (OFAG, 2008). This proclamation has dealt with the appointment and independence of the Auditor General in addition to defining its powers and duties, which include auditing the accounts of all autonomous bodies existing by virtue of Imperial Charters (chartered organizations).

In 1974 (1966 E.C.),after Ethiopian Revolution, proclamation No. 164 of 1979 (1971E.C.) was enacted to redefine the powers and duties of the Auditor

General giving him additional responsibility of auditing mass organizations, development projects as well as conducting performance auditing. No further improvement was enacted to enabling law of the Office of the Auditor General until the power and duties of the Office of the Auditor General were redefined by proclamation 13/1987(OFAG, 2008).

The Auditor General was then appointed by the Emperor and reported to him and the Parliament. The Office of the Auditor General conducted the audit of the Chartered Organizations, which were established to provide essential services to the public, through its chartered Organizations Audit Department (OFAG, 2008).

After the overthrow of the Military regime in 1991 and the establishment of a Federal State Structure by the 1994 Constitution of Ethiopia, the whole arrangement of government auditing structure changed and germane to this duties and responsibilities were separated in to the Federal and Regional audit institutions. Following this Law every regional states council promulgated a proclamation to establish an audit office. While article 101 of the New Federal Government Constitution provided the basis for the appointment, powers and duties of the Federal Auditor General, article 33 and 34 of the Proclamation No. 7/1992 specified the accountability, powers and duties of the Head of each National/Regional Audit and Control Office.(World bank Ethiopian Financial Infrastructure Review (2007).

Based on this constitutional provisions proclamation No. 68/1997 was enacted to establish the Office of the Federal Auditor General (OFAG), which gave the power and duty to undertake Financial and Performance audits (or cause to be audited) on accounts of the federal government offices and organizations, accounts involving budgetary subsidies and special grants extended by the Federal Government to Regional States. In addition to this activities OFAG has empowered to regulate the accounting and auditing profession include licensing of all auditors in the country, issuing a Code of Ethics for Professional

Accountants, and taking disciplinary measures on proven acts of misconduct by professional accountants (Government of Ethiopia, Establishment of Office of Federal Auditor General, 1997).

As per World Bank (2007), OFAG was set up to make efforts in cooperation with concerned organs, to promote and strengthen accounting and auditing professions. OFAG has other broader responsibilities as provided for in the country's constitution. Article 101 (2) of the Constitution states that the Auditor General shall audit and inspect the accounts of ministries and other agencies of the Federal Government to ensure that expenditures are properly made for activities carried out during the fiscal year and in accordance with approved allocations and submits his reports to the House of Peoples Representatives (OFAG, 2008).

The activities of OFAG in regulating the profession include licensing of all auditors in the country, issuing a Code of Ethics for Professional Accountants, and taking disciplinary measures on proven acts of misconduct by professional accountants. World Bank (2007) also indicates that, the ECSC was re-established through Council of Ministers Regulations No.121/2006. One of its objectives, as set out in these regulations, is to formulate standards and certify professionals. For these purposes, the ECSC has established Institute for Certifying Accountants and Auditors (ICAA). According to World Bank (2007), the Ethiopian Professional Association of Accountants and Auditors (EPAAA) have no legal backing and is not a member of International Federation of Accountants (IFAC). The EPAAA was founded in 1972. From 1974 until 1992, EPAAA stayed dormant because of an unfavorable political environment. Following a change of government in 1991, EPAAA was revived. As per World Bank (2007), it has increased its membership from only 10 members in public practice in 1992 to 100 members (30 in public practice) as of September 2007 and it has also membership in Eastern, Central, and South African Federation of Accountants (ECSAFA). EPAAA's purpose is to further professional.

In the case of external audit, Dessalegn et al (2011) identified the two external audit sub-markets in the corporate governance setting of Ethiopia. The first is external audit of state-owned enterprises (SOEs). SOEs are fully government-owned and are governed by board of directors according to proclamation No. 25/1992 (Government of Ethiopia, 1992). Audit Service Corporation (hereafter, ASC), which was established by proclamation No.126/1977 (Government of Ethiopia, 1977), undertakes external audit of SOEs. This sector has a substantial prominence in the Ethiopian economy; for example, SOEs held more than 75 percent of the loan portfolios of commercial banks in the country as of July 2007 (World Bank, 2007 cited in Dessalegn et al., 2011). The second sub-market comprises private audit firms.

In 2010, House of Peoples Representatives of the Federal issued Proclamation 669/2001 Democratic Republic of Ethiopia; to amend the power, duties and responsively of OFAG (The Government of Ethiopia, Federal Auditor General Establishment (Amendment) Proclamation 669/2010, 2010).

Recently, Accounting and Auditing Board of Ethiopia established by Proclamation 847/2014 on January 14, 2015, by the regulation of the Council of Ministers. It is said to be the first public body on accounting and auditing and is empowered to register and license auditors, to conduct investigation and take measures on public auditors and entities having public interest, to issue standards of financial reporting, to give accreditation for accounting entities, to receive and register financial statements of reporting entities, to conduct quality assurance reviews of public auditors and other audit firms, as well as to advise government on matters of financial reporting. According to the Financial Reporting regulation enacted on December 5, 2014, the New Board established under Ministry of Finance and Economic Development serves the Nation as a regulatory body for financial reporting in the country, aimed at the creation of centralized and acceptable financial reporting, to reduce the risk of financial

crisis and to comply with international reporting standards. Registration includes both entities and individuals working in the field and the entities need not fulfill the requirements. However, these businesses should fulfill the standards the Board adapted from the international accounting education standard within five years.

Accordingly, the Accounting & Auditing Board of Ethiopia (AABE) has begun registering individuals and entities who were engaged in accounting and auditing services prior to the establishment of the Board to execute the Financial Reporting Proclamation based on the transitory provision of the regulation issued on January 14, 2015. In connection with NAS, the researcher noted that the new board is issuing license for external auditors for undertaking both auditing and accountancy tasks.

2.1.3 Auditor Independence

Even though the independence of the auditor is quite difficult to define, it is obviously of crucial importance for the auditor's success. Auditor's independence is crucial in the domain of audit quality because the independent audit is spillover to the credibility and integrity of financial statements. Auditor's independence is the calibers of auditor to act, in mind and in appearance, objectively without bias. A lack of independence affects an auditor's ability to exercise objective audit judgments and affects confidence in the audit process. It is essential that auditors to be independent and impartial, not only in fact or mind but also in appearance.(OFAG, Ethiopian Code of Ethics for Professional Accountants and Auditors, 2009).

Alim (2007) found empirical evidence that auditor's independence had a significant effect on audit quality. Other authors like Simunic (1984) said that, "auditor engagements as management consultants can compromise auditor's independence".

Furthermore, Rittenberg et al. (2008) remarks that independence means being objective and unbiased while performing professional services. Ye, P. Carson and Simnett, (2006) said that the economic dependence of auditors on non-audit services, lengthy audit tenure and personal relationships built through alumni employees have contributed to the erosion of auditor independence.

Non-audit service as an audit quality factor can have a considerable impact on auditor's independence, and different regulators at different jurisdiction have been deeply concerned about that. Hence, independent auditing can be considered as a fundamental specification in any Country. In this regard, most of regulators have stated that non-audit services can lead auditors to lose their independence in order to obtain larger non-audit service (Chen,etal, 2008; Gulet *al.*, 2007; Thornton & Shaub, 2014).

Abbott, et al, (2003) state that companies with independent audit committees pay lower non-audit services fees, however Reiner and Bent (2009) proposes that rendering of non-audit advisory services increases income, thereby results a threat to auditor independence. Moreover, Star (2002) said that with the collapse of Arthur Andersen, auditing profession as a whole has been badly blamed and changes were proposed to guarantee that audit firms reduce their overreliance on non-audit services.

However, on the other hand being afraid of losing reputation as well as litigation costs can maintain auditors independent (DeFondet *al.*, 2002).

According to (SEC 2000), regarding non-audit services, has mentioned two situations about auditor's independence: first, the probability that auditors become financially dependent of clients because of non-audit services. Such dependence can results the auditors to prolong their engagement. Secondly, the consulting nature of many non-audit services may lead auditors to act against the audit process, because of the managerial roles.

By gathering more evidence, the auditor can easier be able to state an opinion and by that opinion produce more legitimacy to the audited company (Power,

2003). What can be stated from Powers (2003) view on audit procedures is that he sees the auditors work more as routines to produce paper and by that legitimacy while Pentland (1993) on the other hand see the auditors work as something more spiritual where the audit procedure more like rituals with a higher purpose.

The Independence of the auditor several of the academics and the regulators include independence of the auditors work as an incentive to perform the assignments with high audit quality (Francis, 2004).The US Independence Standard Board (ISB) No.3: defines auditor's independence as to be independent, the auditor must be free only from those factors that are so significant that they rise to the level where they compromise or can reasonably be expected to compromise.

The auditor's ability to make audit decisions without bias that is that the pressures and other factors compromise, or can reasonably be expected to the compromise, the auditor's objectivity (Hay, 2006). The only product of an audit is credibility added to financial statements by the audit report (Stettler, 1982).

Therefore, it is essential that the auditor is independent since no credibility can be added without an auditor's independence (Stettler, 1982). The relevance of the demand for independence can be explained as when the auditors do their reports, the auditors express their personal opinion about the audited material, which is in line with the existing norms. The auditor's opinion can be affected by other circumstances than what the rules implies concerning the audit (Hay, 2006).

According to Hay (2006), defines independence as the demands that the auditors are expected to follow to receive the demanded impartiality and self-containment. Whisenant (2003) also suggests that the auditor is independent when he or she while performing an audit has the ability and will to make evaluations and decisions based on a foundation of existing facts without letting themselves be affected by others wishes and desires.

Lee (1993) suggests that an auditor should claim his/her independent attitude to avoid impact of conflicts of interest. While the actual independence refers the auditors own interpretation and his or her ability to perform the audit, they cannot just act independent to assure that the business is meaningful (Lee, 1993; Hay, 2006).

The auditor needs to convince the market of his independence as a tool to create a demand for the audit services (Wines, 2011). The independence of the auditor has long been known as the most important professional asset of the auditors, and if the auditor act in a way that diminish he/she will risk getting penalties as well as loss of reputation (Johnstone et al., 2001). Watts & Zimmerman (1986) define the auditors reputation as a collateral bond for independence, in that the reputation for the auditor tend to be diminishing the independent than expected will be harmed and also the present value of the theirs audit services will be reduced.

In the USA, there are professional and regulatory bodies that set up requirements, regulations and codes that helps to scrutinize, control and checks the quality of the auditors work, with the purpose of securing the independence and safeguard the interest of the stakeholders (Wines, 2011). Advocacy and client service (AICPA, 1994 cited in Rocco et al., 1997).

Etienne et al.(2010) noted that in 1994, AICPA instituted that firms as well as individual CPAs should exercise professional independence before accepting an audit position in a client's accounting or financial reporting issues. As per Rocco et al. (1997), the AICPA audit standards and the code of professional ethics both emphasize independence as a precondition in expressing an opinion on financial statements.

The AICPA code of professional ethics explain that a CPA shall not express an opinion on financial statements of an enterprise unless her/ his firm is independent with respect to such company and an opinion on the fairness of

presentation of financial statements should be issued only if he or she is independent of the client both in mind and appearance (Rocco et al., 1997).

In the US context, the American Institute of Certified Public Accountants (AICPA) like their counterparts in different associations worldwide, are charged with the responsibility to attest on economic data presented by one party to another; and this attestation function will only be credible if the auditors are independent and competent (Etienne et al., 2010). In situations when the auditor is not independent and their competence is questioned, the effect could be clearly seen in the financial statements in that such data cease to become credible, as it cannot be relied upon for strategic economic decisions by users.

According to Etienne et al. (2010), it could clearly be seen that independence is a cornerstone for successful and reliable audit. If independence is impaired, then it could be reflected in the audit report in terms of its quality.

Further, Pany and Reckers (1984) found that financial statement users were highly concerned about independence impairment when auditors provided consulting services to the audit-client, although they were less concerned if a separate division of the CPA firm performed the consulting services.

2.1.4 Threats affect auditor's independency and Auditor quality

According to IFAC (2004), and IESBA Code 290 independence is potentially affected by self-interest, self-review, advocacy, familiarity and intimidation threats. A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle. Moreover, according to (Beattie & Fearnley, 2002) provision of non-audit services could provide a real or perceived threat to independence.

The threats to compliance are listed and described as follows in the IESBA Code:

Self-interest threats: The threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior. Examples of circumstances that may create this threat include a direct financial interest or material indirect financial interest in an assurance client; Potential employment with an assurance client; and contingent fees relating to assurance engagements.

Self-review threat: The threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant or by another individual within the professional accountant is firm or employing organization, on which the accountant will rely when forming a judgments part of providing a current service. Examples of circumstances that may create this threat include: a member of the assurance team being, or having recently been, a director or officer of the assurance client; a member of the assurance team.

Advocacy threat: The threat that a professional accountant will promote a client or employer's position to the point that the professional accountant's objectivity is compromised. Examples of circumstances that may create this threat include dealing in, or being a promoter of, shares or other securities in an assurance client; and acting as an advocate on behalf of an assurance client in litigation or in resolve disputes with third parties.

Familiarity threat: the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work. Examples of circumstances that may create this threat include a member of the assurance team having an immediate family member or close family member who hold strategic position in the assurance client.

Intimidation threat: the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue Influence over the professional accountant .Examples of circumstances that may create this threat include: threat of replacement over a disagreement with the application of an accounting principle; and pressure to reduce inappropriately the extent of work performed in order to reduce fees.

2.1.5 Audit Quality

Several of academics, professional bodies and regulators have attempted to define what audit quality really is, but there is no universal or clear definition yet on the definition of audit quality (IFAC, 2011).

Turley and Willekens (2008) states that audit quality is normally connect with the ability of the auditor to identify material misstatement in the financial statements and their willingness to issue an appropriate and unbiased audit report based on the audit output.

The widely used definition by many researchers is a definition set by DeAngelo (1981) defined audit quality as the market-assessed joint probability that an auditor will discover an error in the client's account and reports the error to the third parties. She also defines main element of audit quality is.

First, auditor's capacity to identify and willingness to report material misstatement on the client's accounting system that is related to the professional competence or calibre of individual auditor or the audit firm which is one of the element the fundamental principle of Ethical Standards.

Second, reporting the error or irregularity identified by the auditors in his audit report, this is can be related with auditor independence, integrity, objectivity and professional behaviour of the auditors.

Duff (2004), also said audit quality consists of technical and service quality (the degree of customer's satisfaction and meeting their requirements.)

According to Arezoo (2011), audit quality can measure from two dimensions. First, direct measure like reporting compliance with GAAP, quality control review, bankruptcy, desk review and SEC performance. Second, indirect measures like audit tenure of auditor multiple clients in the same industry, and economic dependency of auditor.

Some studies find a significant positive association between audit firm tenure and audit quality, thus supporting the auditor expertise assumptions (Chen *et al.*, 2008)

The appearance of the audit quality can be described in a range from very low to very high audit quality (Francis, 2004).

The audit debacle can be divided into two categories, there can be the auditor, or when the auditors fail to do the audit, report (Francis, 2004) cannot enforce a question of the general accountancy principles.).

According to Francis (2004), describes the ability to explore audit quality, there is no universal definition of what it is and the only product of an audit is the audit report which makes it difficult to describe audit quality. On the other hand, there is easier to lose audit quality when audit failures occur (Francis, 2004). Even though there is no universal definition on the audit quality there is a lot of attempts to assure that the auditors act with high audit quality (Francis, 2004). The stakeholders desire high audit quality and because of that

there is a demand for safeguards that can assure that there is high audit quality (Hayes et al, 2006).

IFAC (2011) contributes a possible perception of the investors/stakeholders view on audit quality; the stakeholder's perceptions on the audit quality are dependent on the ability from regulators and contributors of safeguards to assure its existence. The expectations or the auditor's ability to perform audits and non-audit services with high quality can be drawn to following theories seen from both the regulators and the practitioner's perspectives (Hayes et al., 2006). The auditors have these demands on their work, the demands that the regulators and contributors of safeguards perform rules and control the auditors work (Hayes et al., 2006).

Several researchers examined the factors, which impair audit quality. Size and independence related issues (i.e. the proportion of audit fees received from a particular client compared with non-audit fee, auditor tenure, the provision of NAS and other audit client relationships) are considered elements trigger audit quality. Auditing quality is the combined probability that the auditor will detect and report on defects in accounts (Watts and Zimmerman, 1986).

Some studies find a significant positive association between audit firm tenure and audit quality, thus supporting the auditor expertise assumptions (Chen et al., 2008). In contrast, Alope et al. (2005) argue that audit quality declines with extended audit tenure because, as tenure increases, client firms have greater reporting flexibility and earnings forecast errors decline.

Moreover, IFAC, (2007) explain that, quality is the most fundamental characteristic of international auditing standards, and quality standards should be capable of consistent interpretation, enforceable, capable of unambiguous translation, and designed to achieve a high quality audit.

2.1.6 Safeguards for threats which can impacts independence and audit quality

IESBA define safeguards are actions or other measures that may eliminate threats or reduce them to an acceptable level. Safeguards of any potentials treat can be categories as Safeguards created by the profession, legislation or regulation which include Educational, training and experience requirements for entry into the profession, Continuing professional development requirements, Corporate governance regulations, Professional standards Professional or regulatory monitoring and disciplinary procedures. (IESBA, 2013). Eilifsen et al. (2006) cited in Etienne et al. (2010) noted that different safeguards can be used to mitigate different threats, and one safeguard can be used to mitigate more than one threat simultaneously.

Safeguards in the work environment will vary depending on the circumstances of the treats that can be occurred. Work environment safeguards comprise firm-wide safeguards and engagement specific safeguards.

IESBA identify the following possible firm-wide safeguards that can be set at work environment includes:

- a) Policies and procedures to implement and monitor quality control of engagements.
- b) Documented internal policies and procedures requiring compliance with the fundamental principles.
- c) Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients.
- d) Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client.
- e) Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client.

IESBA identify the following possible engagement-specific safeguards that can be set at work Environment includes:

- a) Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
- b) Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
- c) Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- d) Discussing ethical issues with those charged with governance of the client.

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- a) Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
- b) Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
- c) Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- d) Discussing ethical issues with those charged with governance of the client.
- e) Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
- f) Involving another firm to perform or re-perform part of the engagement.
- g) Rotating senior assurance team personnel.

2.1.7 Audit and non-audit Fee Amount

Fee is any fee established for the performance of any service pursuant to an arrangement (Duska, et al, 2003). In most studies, audit independence is surrogated by the relative magnitude of the audit fee as against the non-audit fee received from a particular audit client.

According to Hoitash (2007), envisaged that the fee paid to auditors can affect audit quality in two ways. First, large fees paid to auditors may increase the effort exerted by auditors and thereby increase audit quality. On the other hand, large fees paid to auditors, particularly those that are related to NAS, make auditors more economically dependent on their clients.

Accordingly, Audit fees decreases with the increase in competition, the greater the number of competitors the lower the audit fees are charged, (e.g., Maher, et al, 1992; Hay et al, 2006).

Audit fee research has also documented client size is an important determinant of audit fees (Simunic 1980; 1984; Francis 1984), and recent research indicates that the relative magnitude of non-audit fees also is higher for larger clients (Abbott et al, 2002). Together, these results suggest that audit opinions may be influenced by the magnitude of non-audit (and audit) fees received from clients.

Moreover, a research undertook by(Hsihui, et al, 2013) in Taiwan context reveal that the sample exhibits substantially more firms reporting NAS percentages slightly below the 25% threshold than those reporting slightly above, consistent with the notion that companies seek to avoid public disclosure of auditor fees. Firms reporting NAS fee percentages slightly below the 25% threshold had significantly poorer audit quality than firms just above the threshold, and therefore being required to disclose auditor fees. Generally,

most of the studies find evidence supporting that Non Audit Service and abnormally higher audit fees in deed reduce the audit quality-putting auditors in a compromising position which threaten their independence (DeAngelo 1981; Choi, et al. 2010). However, Barkess and Simnett (1994) and Craswell (1999) in two large sample studies find no significant association between the level of NAS fees and audit report qualifications.

Geiger and Rama (2003) find that audit fees were positively associated with going-concern modifications, but that NAS fees were not significantly associated with going-concern modification decisions. However, Wines (2011) finds evidence of a negative association between non-audit fees and the issuance of any type of qualified report in a sample of 76 Australian companies.

2.1.8 Audit firm size

In connection with audit firm size, one of the suggestions is to use auditor size as a quality surrogates on the ground that larger audit firms (in terms of market share) provide quality audit than their smaller counterparties.

When studying the “Big Four” WebPages there is several options of service packages for the client. In the package deal, the client can choose one of these packages if desired, this to a fixed price and after the choice, the client can add the audit from the same audit firm (PWC, 2013; KPMG, 2013; Ernst & Young, 2013; Deloitte, 2013). Within the package deals, there are services that refer to the non-audit services and outside the package is the audit. The benefits of choosing the audit simultaneously as the service package are that the prices tend to be more appealing (PWC, 2013; KPMG, 2013; Ernst & Young, 2013; Deloitte, 2013).

According to Feltham, Hughes and Simunic (1991), Dye (1993), Clarkson and Simunic, (1994) said that firms that are wealthy are not economically dependent on their client companies. They are therefore more motivated to carry out proper examinations of client companies with the required independently and quality, therefore, they are able to avoid being sued for wrong reports and in cases of audit failure, they can shoulder their responsibilities, and presumed to have capability to conduct high quality audit.

Clients would pay more to the international big firms due to their Brand name and the higher audit quality provided. Prior studies (Simon et al., 1992) find that the Big Eight or Big Five, now the Big Four (Ernst &Young, Deloitte, PricewaterhouseCoopers (known as PwC) and KPMG) audit firms receive premium fees in many countries compared to non-Big Four (Palmrose, 1986; Francis & Simon, 1987; Butterworth & Houghton, 1995).

2.2 Empirical Studies

There are arguments regarding to the impacts of provision of non-audit service to audit client on auditor's independence and audit quality. To understand these arguments, the researcher explored out the following empirical evidences based on their relevance or importance for this study.

Supporters of the idea of provision of audit services enhances synergies of knowledge spillover and audit efficiency arise from providing both audit and non-audit services. The opponents contend that provision of non-audit services increases the auditor's financial dependency on the client and therefore may impair auditor's independence. Proponents of provision of NAS argue that a clear segregation of the staff performing the consultancy and the staff performing the audit are in place, which is strictly regulated by the accounting law and other directives (Robson, et al, 2007). The auditors only do the audit and the consultants only do the consultancy, but they argue that it is difficult

to draw a clear distinction line between auditing and consultancy, and its objectives and processes is become ambiguous.

Most of empirical researches in different countries exhibit mixed results (positive, negative and no effects).

Empirical studies have shown that at least 70% of the multinational or big companies that hire an audit firm also hire the same firm for non-audit services (Kirby & King, 1997; Bennett & Robson, 1999a). Studies have also shown that smaller companies usually hire an auditing firm for non-audit services (Kirby & King, 1997; Bennett & Robson, 1999a; Burke & Jarratt, 2004). There have been studies that suggest that non-audit services gives competence that is very important for smaller companies survival and their ability to develop competitive benefits (Gooderham et al., 2004; Santoro et al., 2007).

Nutek, 2000; Gooderham et al., 2004). A possibly explanation to this fact can be that the relation established between the audit client and the audit firm throughout the audit (Johan Olsson & Christian Ottoson, 2013). The established relationship that the audit firm obtained from the audit client during the audit may have an impact on the propensity to ask for non-audit services (Johan Olsson & Christian Ottoson, 2013).

Moreover, research concerning auditor independence and audit quality may benefit from cross-country comparisons due to regulatory and cultural differences. Examination of various countries would likely reveal differences in the incentives, perceptions, and behaviors of the multiple parties (auditors, clients, and financial report users). For example, using a sample of Big 6 auditors from seven European countries, Arnold, Bernardi, and Neidermeyer (1999) find some association between litigation risk and the auditor's consideration to perform additional to audit work.

According to (Ratzinger-Sakel, 2013) study, most U.S. studies find no evidence that NAS impair actual audit quality, based on examining Auditors reporting decisions. However, a German study reports that Big 4 auditors are less likely than non-Big 4 counterparts to issue qualified report to clients with high NAS fees. This finding is at least in part due to low litigation risk in Germany, as the “deep pockets” of Big 4 auditors expose them to high litigation risk in the United States, but not in Germany. Therefore, this German finding suggests that the concerns over litigation, rather than over reputation, play a more important role in lessening the economic bond between the client and the auditor.

Davis, et al. (1993), on his research stated that audit data from one large public auditing firm and report that there is “no research evidence for the argument that providing NAS for audit clients creates situations that may lead auditors to compromise the their independency”. (Lennox 1999) also said that, it appears that the relationship between non-audit services and audit quality is ambiguous.

Sharma and Sidhu (2001) examine audit opinions of bankrupt companies and found that higher non-audit service fees influenced audit opinion regarding going concern, and affects audit quality negatively. Additionally, Sharma (2001) and Sharma and Sidhu (2001) examined 49 bankrupt Australian companies and conclude that higher NAS fees were associated with a lower likelihood of receiving going-concern modified reports.

Moreover, (Babatunda and Kolawole 2011) conducted a study, in Nigeria on a research titled “Non-audit service and auditor independence” Investor perspective“ from 142 Investors, the research results, 78.2% of the total respondents agreed that auditors cannot maintain their independence while promoting non-audit services to their audit clients; 24.6% disagreed with this statement, and 66.9% of the total respondents agreed that auditors should not

legally be allowed to provide non-audit services for their audit clients while 31.7% disagreed with this opinion. In addition, subsequent studies by Beattie et al. (1999) and Canning and Gwilliam (1999) of UK and Irish financial statement users respectively both suggested that increasing levels of fees from NAS can impair the perception of auditor independence. Dart (2011) also suggested that UK investors expressed increasing concern about the quality of audit when there was significant provision of NAS.

A study also had been conducted by Salehi and Moradi (2010) in Iran on Iranian accountant's and shareholder's perceptions on NAS and their effects on audit independence. Their results showed that practicing NAS to the same audit clients have strong negative effects on auditor independence. The study was based on 2,151 completed questionnaires that distributed to participants with accounting knowledge (literate participants) and without accounting knowledge (illiterate participants). The majority of the participants confirmed that there is a negative effect on audit independence when there is a large amount of audit fees and illiterate participants have more negative perceptions. They agreed that presenting bookkeeping and managerial consultancy services to the same clients will impair auditor independence.

Whisenant et al., (2003) in a study of 2666 firms in the year 2000 discovered that non-audit fees do not directly influence audit fees and that audit fees do not directly influence non-audit fees.

Antle et al. (1997) found no evidence that the pricing of auditor liability insurance to the Big Six firms was affected by the level of provision of NAS by the individual firms and concluded that because the insurers have such an obvious and direct monetary interest in such matters, this is evidence that the supply of non-audit services has not damaged auditor independence.

The economic theory of auditor independence that postulates the potential for compromise of independence where incentives to do so are present, was tested by Chung and Kallapur (2003), who used a sample of proxy statements from

1,871 Big Four clients, to determine ratios of client fees to total audit firm revenue (to establish economic dependence) and the ratio of the client's NAS services fees to total audit firm revenues. Regression techniques revealed no association between abnormal accruals and the client importance ratios, providing evidence that is inconsistent with the economic theory of auditor independence, but that is in line with the arguments of Goldman and Barlev (1974), who assert that NAS increase an auditor's value to the client, thereby placing the auditor in a stronger position to resist client pressure.

However, a study undertaken by Nada, (2013) on the perceptions of Auditing and provision of NAS, case study in Libya, from the perspective of 147 finance managers, accountants and internal auditors of oil companies, and 100 external audit firms the result suggested that: the provision of NAS to audit clients was found to provide auditors with greater experience of the client's industry and greater access to the client's accounting system. Additionally, such an arrangement was considered to enhance audit quality, but simultaneously it was also believed that a separation of NAS from audit services was desirable since auditors are perceived to have greater credibility when the demarcation is clear.

Moreover, Gul (1989) studied the perceptions of bankers in New Zealand and found that the effect of provision of NAS was significantly and positively associated with auditor independence. Hussey (1999) reported that the majority of the UK finance directors that participated in his study suggested that joint provision of audit and NAS to audit clients should continue to be allowed.

Conclusions and knowledge gaps

Even though, the aforementioned empirical review tried to demonstrate different findings as per their study area and countries context, it does not necessarily mean that it would replicate elsewhere. Moreover; the target population or frame of reference, and research methodology is different among countries. In addition, in the above studies revealed mixed results, which one's conclusion contradicts with another.

The paradox on the provision of non-audit service to an audit client is widely researched in the global era, after the debacle of Big Corporations like Enron, worldcom, and like using different research techniques, however, as far as the researcher's knowledge is concerned a study with similar title or issue is not undertaken so far in Ethiopian context. Nevertheless, there are many studies carried out in connection with other factors like audit fee, firm size, and other factors that can lead to impairment of audit quality and independency, from different industries perspective. Therefore, the current study is a kick-off for the subject matter, and tried to fill the gap, which is mentioned in the above.

CHAPTER THREE

Research Design and Methodology

3.1. Research Design

In order to achieve the research objectives, both quantitative and qualitative (i.e. mixed approach) were used. The researcher used the benefit of mixed methods approach by mitigating the bias in adopting only either quantitative or qualitative approach and to get the advantages of collecting both closed –ended quantitative data and open-ended qualitative data to best understand a research problem.

Regarding sampling technique, the study used purposive sampling only to selected target out of the 74 registered audit firms that provide non-audit service (Grade A , Grade B and C) as a sample. The study used questioner to collect data, from external auditors in the case of private audit firms in Addis Ababa with the main objective of how the provision of non-audit service relationship auditor independency and audit quality, and uses secondary data to review existed regulatory frameworks and safeguarding mechanisms used globally and in Ethiopian context. The survey encompasses both open and closed end questionnaires. The reason for the use of questionnaire for this study is that the main purpose of the study has qualitative and quantitative nature. The study targeted seventy auditors.

3.2. Target of Population

The collection of all possible observations of a specified characteristic of interest is called a population while a collection of observations representing only a portion of the population is called a sample.

In this study, the target population is the 74 private Audit firms in Addis Ababa. The target population for this study was been all private Audit firms that were registered by OFAG and operational in Addis Ababa.

3.3. Sample Design and Sample Size

This study was employs purposive sampling only to selected target out of the 74 registered audit firms in listed on OFAG that provide non-audit service (Grade A and Grade B) as a sample. While Grade C audit firms will be excluded from the study because they are small in size and do not provide such services. Among the 74 audit firms, Grade A 10 audit firms, Grade B 15 audit firms and Grade C 49 audit forms. From these purposely selected 10 audit firms (5 firms from Grade A & 5 firms from Grade B) selected.

The justifications for used purposive sampling were obtained in depth and diverse information from employees who have high involvement in non audit service. The researcher considers that the sample size is sufficient to made sound conclusion about the population, so that it was cover 40% of the total population, which was 10 Audit firms from Group A and Group B. The study target 70 auditors' random select from 10 audit firms and the questionnaire were circulated to them.

3.4. Data Analysis and Interpretation

Data collected using questionnaire was analyzed through descriptive statistics using Statistical Packages for Social Scientist (SPSS). It helps to describe what the data look like, where their center is, how broadly they are spread in terms of one aspect to other aspect to the other aspect of the same data (Leary,1995). Thus, it helps to make comparison between the relation of provision of non-audit service to an audit client on audit quality and independency during provision of non-audit service.

3.5. Data collection Instruments

Primary data has been gathered from principal and/or audit managers, and senior auditors of private audit firms include under the research sample through questionnaires. The types of questioners can be open and closed ended. Questionnaire can save time. Under the current study, open and closed ended questions were prepared for the respondents. A research questioner was adopted from Nedal (2013), and upgrade, from various studies, from the relevant literature review, objectives of the study.

The closed ended questioner was designed based on Likert Scale Model with 5 choices; “strongly agree”, “agree”, “neutral”, “disagree” and “strongly disagree”. The reason why the researcher chose to use a Likert scale is that it is suitable for measuring attitudes or perspective, which is expressed in the purpose of this study.

As it is mentioned before, the instrument tool was both open ended and closed-ended questions for the target participants (external auditors). This is due to the fact that, in the qualitative approach open ended questions are preferable to get further understanding about the phenomenon (Mack et al., 2005), and closed ended questions were suitable for the quantitative approach to measure objective types of response rather than subjective as to whether provision of non-audit service to an audit client can either impair or not impair auditor independence and audit quality. To gather data which was used in the study, self-administered questionnaires will be distributed to research participants.

Secondary data - Document Review has been gathered from publications on professional ethics of accountants issues by OFAG, empirical researches issued so far in this area, from different journals and articles, and different literatures.

3.5.1. Validity, reliability and ethical issues

Validity and reliability of the research measurement instruments influence, first the extent that one can learn from the phenomena of the study. Second the probability that one was obtained statistical significance in data analysis and third the extent to which one can bring meaningful conclusion from the collected data. Most ethical issues in research fall into one of the four categories: protection from harm, informal consent, right to privacy and honesty with professional colleagues (Leedy and Ormrod, 2005).

3.5.1.1. Ethical Issues

Due consideration was given to obtain consent from each participant about their participation in the study. It was strictly conduct on voluntary basis. The researcher tries to respect participants' right and privacy. The findings of the research were presented without any deviation from the outcome of the research. In addition, the researcher was given full acknowledgements to all the reference materials used in the study.

3.6. Data Analysis Method

Following the collection of both qualitative and quantitative data, analysis and interpretation tasks were performing. The collected data were edit, code, group and transcribe in a manner suite to analysis and interpretation. Next, the collect data will analyze using descriptive statistics; the data collected from survey questionnaire were checked for consistency and entered into the SPSS spreadsheet. The analyses were performing with SPSS ver. 20. Descriptive statistics were employed to analyze data and the results were tested with tests of significance. Besides, measures of central tendency used to analyze the questionnaire survey result. Measures of central tendency were used to determine the relative importance of each independent variable in explaining the variation of NAS in Addis Ababa Private Audit firms.

CHAPTER FOUR

Results and Discussion

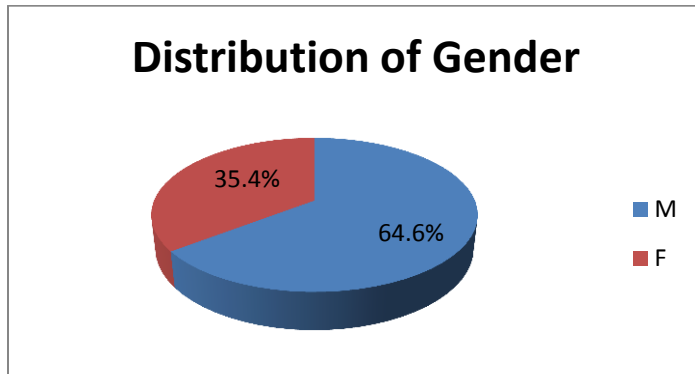
As it is mentioned in the previous chapter, the aim of this study is to analyze the Provision of Non Audit Service to the audit client and Auditors Independence and Audit Quality in private audit firms. 70 questionnaires were distributed to private external auditors and from which 65 questionnaires were collected, giving the response rate of 93%. This shows good response rate.

This chapter presents the analysis and discussions of research findings obtained from the questionnaires. It reports the investigation results obtained from private external auditors .The discussion begins with the questionnaires' response rate followed by age, year of experience working as an auditor, relation of NAS on audit quality, independent and audit fee and perceive threats as a result of dual provision. Under this chapter, the results, which are gained from the respondents, were presented and analyzed with the help of SPSS (i.e. simple descriptive statistics).

4.1 Background Information

The below pie chart shows that 65 responses of these, 42 (64.6%) were male and 23 (35.4%) were female. In general, the following figure shows the distribution of the respondent's gender.

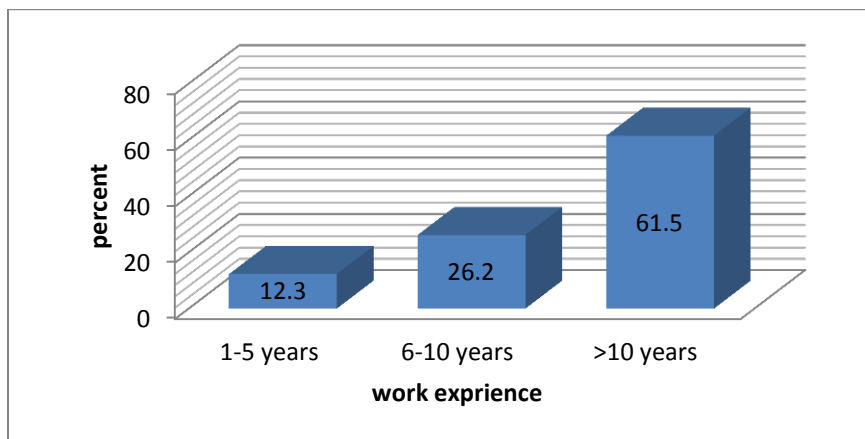
Figure 1: Distribution of Gender



Source: Own Summery Source: SPSS survey data, 2016

As one can see in the figure above, male respondents exceed the female. This indicates that the number of male and female respondents are not proportional instead male covers the majority. The years of respondent's experience is shown in the graph below.

Figure 2: Distribution based on years of Experience



As revealed in the figure above, the distribution of years of experience that the respondents had with working in the auditing profession was not fairly spread out among the categories.

Out of 65 respondents, 40 respondents (61.5% of total respondents) represent a group that covers more than ten years of experience in the industry. This shows that most of the respondent auditors were highly experienced in the auditing industry, and had well understanding and exposure in the audit and Non-audit assignments. Respondents, which have been working in the profession 1 to 5 years, were 8 (12.3% of the total respondents). The rest 17 respondents (26.2% of the total respondents) were having 6 to 10 years of experience.

4.2. Provision of Non Audit Service and Audit Quality

Twelve questions were designed to collect auditor's insights regarding effects of provision of NAS on audit quality. As depicted in the table below, the analysis of respondent's perceptions about the relationship between the provision of NAS and audit quality.

It shows that the majority of the respondents or 90.8 % strongly agreeing or agreeing with the statement the provision of NAS to an audit client gives the auditor more experience of the client's industry and more access to the client's accounting system. This statement achieved highest the mean score (4.36).

Table 1. Q1.1 Auditor more experience of the client’s industry and more access to the client’s accounting system.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	30	46.2	46.2	46.2
Agree	29	44.6	44.6	90.8
Neutral	1	1.5	1.5	92.3
Disagree	3	4.62	4.62	96.9
Strongly Disagree	2	3.08	3.08	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016.

As revealed in the table below, providing NAS to an audit client by a separate engagement team gives the auditor more credibility had the highest second mean score (4.05), with (80.3%) of respondents either agreeing or strongly agreeing with it. This result might reflect the respondent’s confidence in the safeguards of auditor independence from the segregation of duties by splitting the provision of audit and NAS into separate engagement team, which is consistent with the arguments proposed by Nadal ,(2013)and Pany and Reckers (1984).

Table 2. Q 1.4. Separate engagement team gives the auditor more credibility.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	20	35.7	35.7	35.7
Agree	29	44.6	44.6	80.3
Neutral	6	9.1	9.1	89.4
Disagree	10	10.6	10.6	100
Strongly disagree	-	-	-	
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

Sequentially, the third highest mean score (3.71) was achieved by the statement the existence of peer group review (inter firm) reduces impairment of audit quality, with 67.5% of respondents are either agreeing or strongly agreeing with it. This result might reflect the respondent's confidence in the safeguards of auditor independence from the peer group (inter firm) review, to curtail impairment on audit quality.

Table 3. Q1.10.Existence of Peer group review (inter firm) reduces impairment of audit quality

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	15	23.8	23.8	23.8
Agree	31	47.7	47.7	71.5
Neutral	8	12.1	12.1	83.6
Disagree	5	7.3	7.3	90.9
Strongly disagree	6	9.1	9.1	100.0
Total	65	100.0		

Source: SPSS survey data, 2016

As depicted below, the statement with the fourth highest mean score (3.68) was the provision of NAS to an audit client under the effective supervision of effective audit committee from a client side reduces impairment of audit quality, with (67.5%) of respondents either agreeing or strongly agreeing with it.

Table 4.Q 1.11 NAS under supervision a reduces audit committee reduces impairment of Audit quality

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	16	24.4	24.4	24.4
Agree	28	43.1	43.1	67.5
Neutral	8	13.1	13.1	80.6
Disagree	8	13.1	13.1	93.7
Strongly disagree	5	6.3	6.3	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

In contrast, as portrayed in the table below respondents (66.2%) either disagreed or strongly disagreed with the statement prohibiting the external auditor of providing NAS will make it difficult to judge the client's internal control system and this may affect auditor's opinion. It achieved the lowest mean score of (2.35). This indicates that auditors believes provision of NAS is not the only means to assess client's internal control.

Table 5. Q 1.9 Prohibiting the external auditor to judge the client’s internal control system.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	-	-	-	-
Agree	12	18.4	18.4	18.4
Neutral	10	15.4	15.4	33.8
Disagree	29	44.6	44.6	78.4
Strongly disagree	14	21.6	21.6	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

In contrast, as portrayed in the table below the statement with the lowest mean score (2.42) was, Auditors also try to hide their remuneration by assisting non-disclosure in clients financial statements with which more than half, 52.4% of respondents either disagreed or strongly disagreed with this statement. Therefore there remuneration assisting by auditor affects audit quality.

Table 6. Q 1.8 Auditors also try to hide their remuneration by assisting non-disclosure in client's financial statements.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	6	9.2	9.2	9.2
Agree	10	15.3	18.5	27.7
Neutral	15	23.1	23.1	50.8
Disagree	17	26.2	26.2	76.9
Strongly disagree	17	26.2	23.1	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

Moreover, as stated below, the statement with the third lowest mean score (2.55) was Provision of NAS to an audit client impairs audit quality regardless of type and nature of NAS with which more than half, 57.9% of respondents either disagreed or strongly disagreed with this statement. This result might reflect the respondents were provision NAS do not impairs audit quality.

Table 7.Q 1.5 Provision of NAS to an audit client impairs audit quality regardless of type and nature of NAS.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	6	9.5	9.5	9.5
Agree	14	21.7	21.7	31.2
Neutral	7	10.9	10.9	42.1
Disagree	26	39.5	39.5	81.6
Strongly Disagree	12	18.4	18.4	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

Since the overall responses of auditors inclined to the provision of NAS to the client enhance more knowledge and skill about the client's industry. Therefore, the overall summary of responses revealed in the table portrayed below.

Table 8. Non-audit service on audit quality

	Q1.1	Q1.2	Q1.3	Q1.4	Q1.5	Q1.6	Q1.7	Q1.8	Q1.9	Q1.10	Q1.11	Q1.12
Strongly agree	30	14	30	20	6	9	20	6	-	15	16	14
Agree	29	21	29	29	14	20	19	10	12	31	28	12
Neutral	1	5	1	6	7	16	14	15	10	8	8	16
Disagree	3	16	3	10	26	11	8	17	29	5	8	17
Strongly disagree	2	9	2	-	12	9	4	17	14	6	5	6
Mean	4.36	3.26	2.67	4.05	2.55	3.11	3.21	2.42	2.35	3.71	3.68	3.26

Source: SPSS Output survey data, 2016, Overall summary of provision NAS effect on audit quality.

4.3 Provision of NAS on Independency

Seven questions were designed to collect auditor's insights regarding effects of provision of NAS to audit client on auditor independency. As depicted in the table below, the analysis of respondents perceptions about the relationship between the provision of NAS and auditor independency.

It shows that the majority of the respondents or 78.4 % strongly agreed or agreed with the statement existence of Separate audit and non- audit division in a firm curtail the issue of impairment of Independency. This statement achieved the highest mean score (3.92).

Table 9. Q 2.7 Existence of Separate audits and non- audit division in a firm limit of impairment of Independency.

	Frequency	Percent	Valid Percent	Cumulative Percent
Agree	51	78.4	78.4	78.4
Neutral	5	7.7	7.7	86,1
Valid Disagree	4	6.2	6.2	92.3
Strongly disagree	5	7.7	7.7	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

As revealed in the table below, provision of NAS to an audit client leads to economic dependency on the client and causes conflict of interests for the auditor had the highest second mean score (3.19), with less than half (44.6%) of respondents either agreeing or strongly agreeing with it. This result might

reflect the respondents believed on the negative effect of economy or income dependency from NAS. This shows that most of the auditors refrained from taking position, and were indifferent.

Table 10. Q 2.3 Provision of NAS to an audit client leads to economic dependency on that client.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	6	9.2	9.2	9.2
Agree	23	35.4	35.4	44.6
Neutral	9	13.8	13.8	58.4
Disagree	13	20.0	20.0	78.4
Strongly disagree	14	21.6	21.6	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

Sequentially, the third highest mean score (3.11) was achieved by the statement, Non-audit fee higher than audit fee is an indicator of threat to independence of auditor with 44.7% or less half of respondents are either agreeing or strongly agreeing with it. This result might reflect the respondents were aware of the threats might arises from higher Non-audit income.

Table 11. Q 2.4. Non-audit fee higher than audit fee is threat to independence of auditors.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	4	6.2	6.2	6.2
Agree	25	38.5	38.5	44.7
Neutral	14	21.5	21.5	66.2
Disagree	14	21.5	21.5	87.7
Strongly disagree	8	12.3	12.3	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

In contrast, as portrayed in the table below prohibition of NAS to an audit client is only to maintain the perception of independency. It achieved relatively the lowest mean score of (2.87). This indicates that auditors believe provision of NAS can impair auditor indecency, unless it is backed by proper safeguarding mechanisms.

Table 12.Q 2.6 Prohibition of NAS to an audit client is only to maintain the perception of independency.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	7	10.8	10.8	10.8
Agree	15	23.1	23.1	33.8
Neutral	19	29.2	29.2	63.1
Disagree	17	26.2	26.2	89.2
Strongly disagree	7	10.8	10.8	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

Moreover, as revealed in the table below the statement with the second lowest mean score (2.92) was, preventing the external auditors from providing NAS helps the auditor to expand the audit scope and exert more effort in the audit, and results in reduction of impairment of independency with which, 42.9% of respondents either disagreed or strongly disagreed with this statement.

Table 13. Q 2.2 Preventing providing NAS to reduction of impairment of independency.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	7	10.9	10.9	10.9
Agree	17	26.2	26.2	37.1
Neutral	13	20.1	20.1	57.2
Disagree	20	30.7	30.7	87.9
Strongly disagree	8	12.2	12.2	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

As shown in the following table, the mean score (2.95) was providing NAS by the external auditor will reduce the likelihood of issuing a qualified audit report with which, less than half 43.2% of respondents either disagreed or strongly disagreed with this statement. As the mean almost close to three this shows that most of the respondents are indifferent.

Table 14. Q 2.5 Providing NAS by the external auditor will reduce the likelihood of issuing a qualified audit report.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	10	15.3	15.3	15.3
Agree	19	29.2	29.2	44.5
Neutral	8	12.4	12.4	56.9
Disagree	17	26.2	26.2	83.1
Strongly disagree	11	16.9	16.9	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

Since the overall responses of auditors inclined to the provision of NAS to the audit client during audit and non-audit service provided by different department. However, auditors also sensed the negative influence of higher NAS income on auditor independency. Moreover, most of the respondent auditors were indifferent to side to agree or disagree statements, and choose to be neutral; these are reflected by low agreed or disagreed rates. The overall summery of the responses revealed in the table portrayed below.

Table 15. Effect of non audit service on independency

	Q2.1	Q2.2	Q2.3	Q2.4	Q2.5	Q2.6	Q2.7
Strongly agree	11	7	6	4	10	7	51
Agree	20	17	23	25	19	15	5
Neutral	9	13	9	14	8	19	4
Disagree	15	20	13	14	17	17	5
Strongly disagree	10	8	14	8	11	7	-
Mean	3.11	2.92	3.19	3.11	2.95	2.87	3.97

Source: SPSS survey data, 2016, overall summary of provision NAS effect on audit quality

4.4 Perceived Threats as a result of dual Provision

Under this section, the research shows the survey result on the type of threat emerged during the course of provision of NAS, and the possible type of safeguards that can be set by the regulatory and/or professional bodies and safeguards that can be set on working environment at the firm and specific engagement level in order to reduced possible threat that reflected, and could be magnified in the industry related to NAS.

International Ethical Standard Board of Accounting (IESBA) states that possible source of those threats that affect auditor independency and audit quality. Regarding to the safeguards, IESBA identify three possible ways of establishing safeguards that can be established by the profession and the regulatory bodies, safeguards established by the working environment at firm-wide level and at specific to engagement level, which is used to reduce impairment of audit quality and independency.

As shown in the table below, the mean value of self-review, threat familiarity threat, and self-interest threat is 3.68,3.49, and 3.42 respectively, this indicate

that most of respondent firms select 'agree' and 'strongly agree', moreover, percentage figure of these there type of threats are 75.8,%, 62.10% and 53.8% respectively. The figure indicates that auditors agreed this type of threats is mostly occurred during the course of provision of NAS to audit-Client. The other type of threats namely Advocacy and Intimidation threat scores a mean value of 3.16and 3.32 respectively. Moreover, percentage figure of these types of threat is 54%. As compared to the above four-mentioned type threat, this type of threat is not commonly presumed by external auditors to be existed during dual provision.

Table 16. Perceived Threats as a result of dual provision

Type of Threats	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean Value for threat	% of respondent agree and above
Self-interest threat	7	11	12	26	9	3.42	58.3%
Self-review threat	8	5	9	32	11	3.68	75.8%
Advocacy Threat	9	13	9	26	8	3.16	54%
Familiarity Threat	9	4	12	27	13	3.49	62.10%
Intimidation On threat	10	10	15	21	9	3.32	54%

Source: SPSS survey data, 2016, overall summery of perceived threats during dual provision

4.5. Effect of None Audit Service on Audit Fee

Eight questions were designed to collect auditor's insights regarding effects of provision of NAS to audit client on audit fees. As depicted in the table below, the analysis of respondents perceptions about the relationship between the provision of NAS and audit fees.

It shows that the majority of the respondents or 72.7 % strongly agreeing or agreeing with the statement. Non-audit fees are in many cases higher than audit fees. This statement achieved the highest mean score (3.84).

Table 17. Q 4.7 Non audit fees are in many cases higher than audit fee

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	15	23.7	23.7	23.7
Agree	32	49.2	49.2	72.9
Valid Neutral	7	10.5	10.5	83.4
Disagree	11	16.6	16.6	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

As revealed in the table below, during provision of NAS to an audit client, clients usually have better position to disclosure audit and audit remuneration had the highest second mean score (3.57), with (56.8%) of respondents either disagree or strongly disagree with it.

Table 18. Q 4.8 Audit clients properly discloses auditor remuneration

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	7	10.7	10.7	10.7
Agree	30	46.1	46.1	56.8
Neutral	8	12.1	12.1	68.9
Disagree	10	15.2	15.2	81.8
Strongly disagree	5	28.2	28.2	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

In contrast, as portrayed in the table below Providing NAS by the external auditor will lead to a reduction in audit fees. It achieved relatively the lowest mean score of (2.82). This indicates that auditors believe provision of NAS, and Non-Audit fee arises from this service does not have synergy with audit fee. This is consistent with prior literature, (Whisenant et.al., 2003).

Table 19. Q 4.1 Providing NAS by the external auditor will lead to a reduction in audit fees.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	6	9.2	9.2	9.2
Agree	18	27.7	27.7	36.9
Neutral	12	18.5	18.5	55.4
Disagree	21	32.3	32.3	87.7
Strongly disagree	8	12.3	12.3	100.0
Total	65	100.0	100.0	

Moreover, as revealed in the table below the statement with the second lowest mean score (2.84) was, Preventing the external auditor from providing NAS will lead to the increase in the number of work hours, cost and effort necessary for performing the audit with which, 44.6% of respondents either disagreed or strongly disagreed with this statement.

Table 20Q 4.5 Preventing the providing NAS will lead to the increase in the number of work hours performing the audit.

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	6	9.2	9.2	9.2
Agree	16	24.6	24.6	33.8
Neutral	14	21.5	21.5	55.4
Disagree	22	33.8	33.8	89.2
Strongly disagree	7	10.8	10.8	100.0
Total	65	100.0	100.0	

Source: SPSS survey data, 2016

Table 21. Effect of non-audit service on audit fee

	Q4.1	Q4.2	Q4.3	Q4.4	Q4.5	Q4.6	Q4.7	Q4.8
Strongly agree	6	8	10	6	6	10	15	7
Agree	18	14	28	13	16	18	32	30
Neutral	12	19	12	24	14	15	7	8
Disagree	21	17	10	16	22	16	11	10
Strongly disagree	8	7	5	6	7	6	-	5
Mean	2.82	2,92	3.61	2.95	2,84	3.05	3.84	3.57

Source: SPSS survey data, S 2016, overall summary of effect of Non-audit service on the audit fee.

In general, the above results are consistent with prior literature (Nadal, 2013, Gul, 1989, and Hussey, 1999) that identifies the provision of NAS to audit clients as having the potential to increase the auditor's client knowledge, and therefore, enhance the probability that problems would be discovered. Therefore, for a given level of independence, NAS may increase audit quality.

However, another commonly mentioned advantage of providing NAS to audit clients is the potential cost advantage or reduction in audit fee arising from knowledge spillovers, has not been supported by external auditors in Ethiopia. Moreover, professional also afraid of that the economic dependency that might arises from NAS which can lead impairment of audit quality and independency which is consistent with prior literature (DeAngelo 1981; Choi, et al. 2010).

4.7 Analysis of open-ended question

Section three of the questionnaire includes open-ended questions were prepared for the respondents firms. Open-ended questions are useful when the researcher want to see how respondents discuss an issue or discover what is on their minds without imposing an agenda (Lake and Harper, 1987 cited in Pitchaya et al., 2010). Moreover, open-ended questioner allows unlimited number of possible answers and unforeseen findings can be tapped, which were not captured using closed ended questions. It gives an opportunity to the respondent to answer in detail and can clarify their responses. Even though there was no a holistic overview of responses for the questionnaire from the respondents, the researcher tried to see and analyses via SPSS what the majorities of the respondents agreed on the open ended questions. The researcher does not account every response due to the fact that many unique responses from the respondents.

The first open-ended question asked the respondent auditors regarding the fairness of provision of NAS to an audit client. As it is mentioned above; there was no comprehensive overview of responses for these questions. Most of the respondent agreed that, if proper safeguarding mechanisms emplace at firm and client level, it is fair to provide NAS to audit clients based on the arguments mostly mentioned like knowledge spillover, and the need to expand the audit business not only through audit but through also using NAS. On the other hand, few respondents disagreed on provision of NAS to audit client based the argument of economic dependency, and from the firm believe

'auditor should not review his own work' and the prevailing loose supervisory scrutiny.

The second open-ended question asked to the respondent auditor's was the influence of provision of NAS to audit client to issue unqualified or clean report when there were irregularities. Most of respondent auditors argue that, it only affects auditor's judgment, in the absences of proper safeguarding mechanisms, which they believe it can be curbed by placing safeguarding mechanisms. However, small numbers of respondent auditors appreciate the problem and argued that auditor could be tempted to retain a customer due to high income of NAS, and may refrain from qualifying audit reports, which have irregularities or defects, supposed to be qualified. Moreover, some auditors also argued that the nature of NAS determined for qualification or not.

The third open-ended question asked to the respondent auditors concerning the relation between the amount of audit fee and provision of NAS to an audit client, most of the respondent auditors argued that a base for setting an audit fee is drawn from different factors not directly attributed to NAS, and believe it has no relationship. However, some respondent auditors believe that most of the time NAS fee is higher than audit fee and affects audit quality negatively.

The forth open-ended question asked to the respondent auditors concerning the safeguarding mechanisms need to emplace to curtail impairment of audit quality and independency. Most of the respondents agreed, and mentioned importance of separate engagement team, department, rotation of audit partners, and inter- firm or peer group review as a way forward for problems relation to this.

The Fifth open-ended question forwarded to the respondent auditors has been the regulatory scrutiny regarding NAS. Most of respondents said that the former licensing body or regulatory organ has not established a complete set of guideline for each types of NAS service to be practice, and the required

safeguarding mechanisms need to be emplaced. Moreover, most of external auditors said that OFAG has not overseen their audit and NAS closely.

However, the researcher observed that Ethiopian code of Ethics for professional accountants and auditors (OFAG, 2009, pp.33-40) clearly express the type of non-assurance services (non-audit services) allowed to provide to an audit clients, like valuation services involves no significant level of subjectivity, Provision of Taxation Service, and Provision of It system, and the code of ethics prohibited, preparing accounting records and Financial statements, valuation involves significant level of subjectivity, most of Internal Audit works , and corporate finance activities.

On the last question regarding auditor's familiarity with NAS, which results serious audit threat that cannot be minimized using formal safeguarding mechanisms, and required to be banned by the regulatory body. Most of auditors believe that none of the non-audit services are above safeguarding systems, and all should be allowed. However, some auditors argue that Accountancy, Tax advisory, and capital restructuring services, should be prohibited from providing by external auditors to an audit client.

In general, based on the responses on open ended question from the respondent firms it is possible to conclude that private audit firms have inclined to the fairness of providing NAS to audit client, and they believe and support the positive impact of provision both audit and NAS to an audit client, if a firm has a capacity to establish strong defense mechanisms, which enable audit firms to challenge or curb ethical flaws, and audit threats which might be arisen from dual provision. Moreover, most of the auditors also agreed on the importance of safeguarding mechanisms from the client side too, like promoting good corporate governance, and proper oversight by regulatory body Accounting and Auditing Board of Ethiopia (the incumbent AABE).

CHAPTER FIVE

Conclusions and Recommendations

The aim of this chapter is to give a general overview about the whole study and make broad conclusions drawn from the findings of the results. Finally, based on the findings the researcher put some recommendations under this chapter

5.1 Conclusions

The objective of the study was the relationship of provision of NAS on auditor independency and audit quality. Auditor's independence and audit quality was considered from the viewpoint of the external auditors, it was questioned whether provision of NAS to audit client has an impact on the auditor's independence and audit quality. In order to investigate the findings; the researcher used a sample of ten audit firms which includes a total of 70 auditors in Addis Ababa. The researcher used purposive sampling technique and collected primary data through questionnaire, and also tried to see secondary data's like the new proclamation of the formation of Association of Chartered Certified Accountants Accounting and Auditing Board of Ethiopian (AABE). The responses collected were analyzed using a quantitative and qualitative approach with the help of SPSS. Having this, the researcher analyzed the perceptions of external auditors based on how provision of NAS affects auditor's independence and audit quality using different parameters for each elements of the research title (independency and audit quality).

Moreover, the researcher analyzed relation of NAS on audit fee, and perceived threats (i.e. self-interest threat, self-review threats, advocacy threats, familiarity threats and intimidation threats) that can be immersed in the normal audit undertakings and might be escalated during provision of NAS.

According to the view of most of the respondent external auditors, the results suggested that provision of NAS does not negatively affect auditor independency and audit quality, if a firm and client emplaced proper safeguarding mechanisms like undertakings audit and NAS by separate engagement team, separate departments, rotation of audit partners, and peer(inter-firm) review. Moreover, an external auditor acknowledge the knowledge-spillover drives from NAS and has positive impact on audit quality, and believe it helps to underpin their understanding regarding the client's industry. However, most of the respondent auditors agreed on the influence of higher income from NAS on auditor's independency and audit quality, in the absence of properly implemented safeguarding mechanisms from the firm and client side, and loose regulatory scrutiny.

Self-review, familiarity, and self-interest threats are presumed to be escalated in course of provision of NAS to an audit client by respondent private external auditors, and it could be reduced to the acceptable level by properly emplacing safeguarding mechanisms mentioned above.

5.2 Recommendations

The area under this study is an important subject not only to the auditors themselves but also other users of audit reports, and the wider public. Regarding to this, in the introductory chapter the researcher argued that from a practical perspective, the auditor independence is the cornerstone for many stakeholders who have strong stake on the credibility of audit reports. As individual auditor's reputation increases, which may also result to an increase in the reputation of the general profession. Since provision of NAS to audit clients is highly debatable and a delicate subject in the global era, the study recommends the following points to be addressed in Ethiopian context.

First, auditors should take maximum professional due care and diligence during commissioning their professional duty in general, and in NAS in particular in order to eliminate or reduce the audit threats to acceptable level.

Secondly, putting emplaces proper safeguarding mechanism at firm and clients level is crucial to curb or reduce audit threats to acceptable level which arises from dual provision. The result from the study indicates that most of the auditors believe former licensing body, OFAG, did not establish a complete set of guidelines for each type of NAS, allowed or prohibited; size, structure, and capacity of audit firms which are eligible to undertake this activity, and the required specific safeguarding mechanisms for each types of NAS need to be emplaced. However, the researcher observed that OFAG has a complete set of guide line on professional code of ethics for the type of NAS allowed, and/or prohibited, and specific safeguarding mechanisms designed for each types of NAS, nevertheless, externals auditors are not familiar to the professional code of ethics related to NAS. Moreover, OFAG failed to properly scrutinize how audit and NAS have been handling by external auditors so far. Therefore, the incumbent AABE should hastily fix the aforementioned gap of the OFAG in this regard, and should continuously provide awareness creation trainings about the professional ethics, which need to be complied by external auditors.

Thirdly, according to World Bank, (2007) review, the Auditing, Accountancy, Management Consultancy Services related to the Accounting, and Auditing profession formerly directed and overseen by different organs, since duplications of mandates by different licensing and regulatory bodies exacerbates the problem in connection with audit and non-audit service quality decline in general. Therefore, consultancy activities related to accounting and finance, and audit service should have to be guided by single regulatory organ.

Moreover, the respondent auditors suggested that the new board should promote good corporate governance elements specifically related to NAS, like

the presence of effective audit committee in big companies, who would supposed to closely review the work of external auditors. In addition, other jurisdictions which allows NAS to audit client mostly compelled clients to properly disclose the nature, and amount of NAS fees (one dimension of safeguarding mechanism from a client side).Therefore, the new board should revisit the existing guidelines of the OFAG code of ethics and should up-graded in light of the best practices.

Generally, the study examined NAS broadly and from the insight of the practitioner auditors only, and as there is a possibility that specific NAS may have different effects upon auditor independence. Therefore, the researcher recommends future research could carry out or focused on different types of NAS, amount or ratio of audit to non-audit fee and its implication on independency and quality, and perception or reaction of investors to invest in companies, which are audited by auditors who provided both audit and NAS to an audit client.

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Appendix I Questionnaires

Dear Sir/Madam

The intent of this questionnaire is to explore information regarding the Impact of provision of Non-audit Service to an audit client on auditor's independency and audit quality from the perspective of External private audit firms located in Addis Ababa. The questionnaire will distribute 8 purposely selected private audit firms. The information you provide in response to the items in the questionnaire will be used as part of data needed for a study of Impact of provision of Non-audit Service to an audit client on auditor's independency and audit quality as a partial fulfillments of the requirements for the Masters of Accounting and Finance St. Mary's University.

Please provide some background information about yourself by ticking the most appropriate box in each of the following questions, your name is not important to mention in the questionnaire.

Finally, your response to this questionnaire will serve, as source of information to the research paper to be used for thesis purpose .Any response you provide here is strictly confidential and will be used exclusively for the research purpose. Your honesty in responding the right answer is vital for the research outcome to be reliable.

Thank you for your kind cooperation in advance!

1. Your gender? Male Female
2. How many years of experience do you have as an auditor?
 - 1-5 years
 - 6-10 years
 - >10 years

Section Two. Closed Ended Questions regarding Provision of non-audit service to audit client.

Below are lists of questioners relating to the above subject? Please indicate whether you agree or disagree with each statement by ticking (√) on the spaces that specify your choice from the options that range from “strongly agree” to “strongly disagree”.

Key

SA=Strongly agree N= Neutral SD= Strongly Disagree
 A=Agree D= Disagree NAS=Non-audit Service

S.No	1) Effect of Non-Audit service on Audit Quality	SA	A	N	D	SD
1.1	Provision of NAS to an audit client gives the auditor more experience of the client’s industry and more access to the client’s accounting system.					
1.2	Provision of certain types of NAS only impairs audit quality.					
1.3	Preventing the external auditor from providing NAS will lead big audit firms to pullout from the audit market; hence small audit firms would engage widely in the audit market and affect the audit Quality negatively.					
1.4	Providing NAS to an audit client by a separate engagement team gives the auditor more credibility.					

1.5	Provision of NAS to an audit client impairs audit quality regardless of type and nature of NAS.					
1.6	Provision of NAS to an audit client reduces the probability of a threat to switch auditor.					
1.7	No Providing NAS by an external auditor will motivate a firm to assign a team with high qualifications to perform the audit tasks to this client.					
1.8	Auditors also try to hide their remuneration by assisting non-disclosure in clients financial statements about such remuneration					
1.9	Prohibiting the external auditor of providing NAS will make it difficult to judge the client's internal control system and this may affect auditor's opinion.					
1.10	Existence of Peer group review (inter firm) reduces impairment of audit quality					
1.11	Non-audit services under supervision of effective audit committee from clients side reduces impairment of audit quality					
1.12	Provision NAS by Specialized non-audit firms reduces impairment of audit quality					
S.No	2) Effect of Non-Audit service on Independency	SA	A	N	D	SD
2.1	Provision of NAS services by auditor affects auditor independency					
2.2	Preventing the external auditors from providing NAS helps the auditor to expand the audit scope and exert more effort in the audit, and results in reduction of impairment of independency.					
2.3	Provision of NAS to an audit client leads to economic dependency on that client and causes a conflict of					

	interests for the auditor					
2.4	Non-audit fee higher than audit fee is an indicator of threat to independence of auditors.					
2.5	Providing NAS by the external auditor will reduce the likelihood of issuing a qualified audit report.					
2.6	Prohibition of NAS to an audit client is only to maintain the perception of independency.					
2.7	Existence of Separate audit and non- audit division in a firm curtails the issue of impairment of Independency.					
S.N	3) Perceived threats as a result of dual provision	SA	A	N	D	SD
3.1	Advocacy Threat: The auditor is asked to promote the client's position or represent them.					
3.2	Self-review threat: Auditor has to re-evaluate work performed by himself					
3.3	Self- interest threat: financial or other interests of members or their close family					
3.4	Familiarity threat: Auditor is too sympathetic or trusting of the client because of a close relationship with them					
3.5	Intimidation Threat: intimidates the auditor to give an unqualified opinion otherwise not re-appoint him					
S.No	4) Effect of Non-Audit service on the audit fee	SA	A	N	D	SD
4.1	Providing NAS by the external auditor will lead to a reduction in audit fees.					
4.2	Preventing the external auditor from NAS will lead to demotivate new entrant auditors to the market, and results in decrease in the number of auditors who provide audit services and; hence will lead to higher					

	audit fees					
4.3	NAS yields greater income in comparison with audit services					
4.4	Prohibiting provision of NAS by the external auditor will lead to the absence of any allowed discount for providing more than one service at a time.					
4.5	Preventing the external auditor from providing NAS will lead to the increase in the number of work hours, cost and effort necessary for performing the audit					
4.6	Client companies do not properly disclose information about audit and non-audit fees.					
4.7	Non-audit fees are in many cases higher than audit fees					
4.8	Audit Clients properly discloses auditor remuneration					

Section 3: Open ended questions

1. What is your position in fairness of provision of non-audit service to an audit client?

2. As an auditor what is your insight about the influence of provision of non-audit service to an audit client to issue unqualified opinion, when there were irregularities.

3. How do you see the relationship (i.e its direction) between the amount of audit and non-audit service fee and provision of both audit and non-audit service to a client?

4. What is your insight about type of safeguarding mechanisms could be emplaced by an audit firm which helps to curtail impairment of audit quality and independency?

5. What is your insight about the regulatory scrutiny on provision of non-audit service to audit client? Do you believe OFAG established complete set of guideline for different types of non-audit services to be provided, and the required safeguarding mechanisms needs to be implaced for each types of services?

6 .Is any kind of non-audit service you are familiar so far that can create a threat which cannot be minimized using safeguarding mechanisms and need to be banned?
