Efficiency of External Audit Engagement and Its Determinants in Ethiopian Share Companies

A thesis Submitted to the School Graduate Studies of Jimma University in Partial Fulfillment of the Award of the Degree of Masters in Accounting and Finance (MSc in AcFn)

By:

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JIMMA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

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JIMMA, ETHIOPIA

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DECLARATION

I hereby declare that this thesis entitled "Efficiency of External Audit Engagement and Its Determinants in Ethiopian Share Companies", has been carried out by me under the guidance and supervision of Mr. Yonas M. and Mr. W/Michael Sh.

The thesis is original and has not been submitted for the award of degree in any university or institutions.

Researcher's Name	Date	Signature
Fekadu Agmas	________________	________

CERTIFICATE

This is to certify that the thesis entities "Efficiency of External Audit Engagement and Its Determinants in Ethiopian Share Companies" , Submitted to Jimma University for the award of the Degree of Masters in Accounting and Finance (MSc in AcFn) and is a record of Valuable research work carried out by Mr. Fekadu Agmas, under our guidance and supervision.

Therefore we hereby declare that no part of this thesis has been submitted to any other university or institutions for the award of any degree.

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Co-Advisor's Name	*Date*	*Signature*
______________________	______________________	__________

Abstract

The main purpose of this study is to examine the efficiency of external audit engagement and its determinants on Ethiopian share companies. This study is focused on external audit firms and there are about 65 private audit firms in Ethiopia, registered by the Federal Office of Auditor. The senior external auditors and the supervisory auditors of purposively selected 27 external audit firms are the source of the necessary data to the researcher through the administered questionnaires and interviews. Besides, the objective of this study is to examine the direct relation effects of internal control system, firm size, organizational independence, auditors' qualification and proficiency, audit fees, and auditors' reputation for the efficiency of external audit engagement on share companies. According to the regression outputs made using Stata 12 software the internal control system, organizational independence, auditors' qualification and proficiency, and audit fee was contributed for the efficiency of external audit engagement on share companies positively and significantly. The rest two variables; the size of external audit firms and the auditors' reputation were positively related to the efficiency of external audit engagement but their contribution to the external audit engagement was statistically not significance. All of these six independent variables are making 74.51% of the contributions for the efficiency of external audit engagement on share companies. The external audit firms should understand that the contributions of these variables were jointly significant to identify any noncompliance activities in their clients particularly share companies and to add values for the external audit efficiency in share companies.

Key Words: *Determinants for efficiency of external audit engagement, Efficiency of external audit engagement, External audit, External audit firms, Share companies*

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ACRONYMS

- **ADTRREP:** Auditors' Reputation
- **AICPA:** American Institute of Certified Public Accountants
- **ASC:** Audit Service Corporation
- **AUDTFEE:** Audit Fee
- **AUDITEF:** Efficiency of External Audit Engagement
- **AUDTRQP:** Auditors' Qualification and Proficiency
- **CAAT** Computerized Auditing and Accounting Technology
- **CPA:** Certified Public Accountants
- **DW:** Durbin-Watson stat
- **FIRMSIZ:** Firm Size
- **IFAC:** International Federation of Accountants
- **IAASB:** International Auditing and Assurance Standards Board
- **INTCSYS:** Internal Control System
- **ISA:** International Standard on Auditing
- **OLS:** Ordinary Least Square
- **ORGINDP:** Organizational Independence
- **PCAOB:** Public Company Accounting Oversight Board
- **SEC:** Securities and Exchange Commission
- **OAG:** Office of the Audit General
- **SAP:** Statement on Auditing Practice

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the Study

In a decision-making process, decision makers rely upon information, financial statements, as prepared and presented by the management of an entity. The possibility that the information upon decided on is inaccurate is called the ‘information risk’. In connection to this, Elder (2010) state that the most common way for users to obtain reliable information (reducing the information risk) is to have an independent audit performed. To enhance the degree of confidence of the intended users of the financial statements, a financial statement audit will be conducted by external auditors. Thus, decision makers use the audited information on the assumption that it is reasonably complete, accurate, and unbiased.

Based on audit engagements, audit reports will be issued which represents the auditor’s communications of findings to financial statement users and it contains information about the audit, including its scope, and an opinion regarding the fair presentation of the financial statements. Whenever the advance of civilization brought about the necessity of one man being entrusted to some extent with the property of another the advisability of some kind of check upon the fidelity of the former would become apparent (Brown, 1986). As a result, auditors must promote their abilities in order to raise the likelihood to depend more on the auditor's report and audited financial statements which are more important, impartial and truthful for the decision makers. To make such qualities auditor’s auditors qualification is necessary and it has a vital contribution to audit efficiency. Besides, audit efficiency is not only affected by auditor qualification, the company’s internal control structure might also be another feature.

More recent times the Global Financial Crisis has understood policy makers once again concentrate attention on the significance of an effective audit role as a key element in effective capital markets and try to identify key drivers of audit efficiency. For example, in the US the Advisory Committee on the Auditing Profession (2008) was organized to deliver advice to the US Treasury Department on the auditing occupation. Likewise, in the UK the Financial Reporting Council released The Audit Quality Framework (2008), correspondingly in Australia; The

Treasury released Audit Quality in Australia– a Strategic Review (2010). These soundings and regulatory modifications make it pure that there has been substantial frustration with the effectiveness of corporate governance, the efficiency of the audit process and the starring role of auditors and auditing. In reaction, regulators and the accounting professionals have engaged a number of policy actions to develop audit efficiency in both fact and appearance. Current examples include the SEC's recommended prohibition on audit firms undertaking non-audit services (NAS) in 2000 (SEC 2000) and the quick approval of SOX resulting Enron's breakdown (Francis 2004). For instance, while audits are currently mandatory by law, previous empirical evidence in audit literature advocates that presence of financial statement auditing was prevalent long before legal requirements. Specifically, in the U.S. in 1926 before any audit regulation, independent auditors checked as much as 82% of the companies on the New York Stock Exchange (Benston, 1969; Chow, 1982). This observation evidently shows the fundamental significance of auditing as economical external governance mechanism giving protection for stakeholders or users of financial statements.

However, these policy results have been made in spite of the fact that the empirical signal regarding factors that can improve or weaken audit efficiency is questionable and indeterminate. However, research into insights of audit efficiency is vital because it determines the reliability of the audit report (Shockley 1981), and that have the potential to rust public confidence in the truthfulness of the financial reporting system (Pany and Reckers 1988). Accordingly, attaining an understanding of factors that affect insights of audit efficiency is significant because it can help regulators and the accounting professionals to articulate policy grounded on empirical evidence rather than on a priori expectations (Schelluch and Thorpe 1995). This signal is also worthwhile in safeguarding that policies and practices sustenance confidence and credibility in the audit task by incorporating features found to be comparatively more important in perceptions of audit efficiency.

Indeed, in the long run existence of businesses, the efficiency of external audit engagement has a significant role in various sound decisions made by external users using financial statements prepared by those businesses. Thus, ineffective and inefficient employment of external audit engagements in the sector will create different sorts of problems. Some studies are taken in different parts of the world; Naghashiyan (1393) in his article assessed the effect of internal auditor's performance quality on execution time of external audit, Rezaee (1391) in his article scrutinize the impact of internal audit on external audit practice, Pezeshkzade (1391) in his article investigation the dependence of external auditors on various types of internal audit were evaluated, Samavati (1379) in her research investigation the practice of analytical technique, definition value and usage of financial external audit built on small and medium organizations in Iran were taken. Some other studies also focus on audit quality on Small and medium-sized enterprises (Umar, 2011), audit effectiveness on Ethiopian public sector (Dessalegn, 2007), and the usefulness of accounting comparability for audit engagement (Hongbo, 2012). Some other studies were also taken place in the different area of audit practices; however, the problem of efficient employment of external auditing on share companies remains an open question. Thus, the study was attempted to examine the efficiency of external audit engagement on share companies of Ethiopia. Consequently, the study delivers empirical evidence on the features that are supposed to affect audit efficiency, specifically the relative importance of audit team and audit-firm attributes in affecting audit efficiency as perceived by the receiver of audit services. Examining audit engagement efficiency in Ethiopian business environment is significant grounded on the significance of reaching a highly efficient auditing process in Ethiopian share companies. One of the significant sector or business organization in Ethiopia is audit firms, this business organization is vital to the Ethiopian economy by asserting economic events in share companies. Consequently, one can argue that auditors are vitally important to the audit sector that provide value for share companies.

1.2. Background of the Organization

Ethiopia, located in the Horn of Africa, is the ancient sovereign country in Africa and one of the ancient sovereign countries in the world. The history of Ethiopia's Supreme Audit Institution (SAI) drives back to the first 1931 constitution, which focuses the significance of the appropriate collection of the public revenue and the need of procedures to control public expenditures but stopped the lack of either referring to or necessitating any audit as such. This, in fact, had to pause for proclamation 69/1944, which recognized the Commission for Audit. Under this proclamation, the Commission was assigned to the audit of the financial statement of the Ministry of Finance, through the financial transactions of other ministries were reviewed and monitored by the Ministry of Finance itself. A Comptroller and Auditor General and a Director General controlled the Commission. The Commission testified directly to the Prime Minister. The Commission for Audit had neither the professional independence of modern day SAIs nor the comprehensive range of audit covering budgetary organizations of the period. However, the latter limitation was revised after only 2 years when proclamation 69/1944 was amended by Proclamation 79/1946. The amended proclamation consolidated the audit of all government accounts in one audit department, which was established as the Audit and Control Department, which sustained under the management of the Comptroller and Auditor General and still testified to the Prime Minister. Although it’s standing, which clears its independence, remained unchanged, its power and duties were considerably enlarged.

The Audit and Control Department sustained to the role until 1952 when it was combined with the Ministry of Finance's Control Department without any statutory provision. This verified to be a clear hindrance in the process of emerging an independent national audit institute. But the proclamation of the 1955 reviewed constitution place Ethiopia back on course to finding such an institution. Articles 120 and 121 of the reviewed constitution of 1955 evidently discussed the rights and duties of auditing all ministries, departments, and agencies to the Auditor General, whose office was then recognized as a distinct, autonomous entity that testified directly to the Emperor and to Parliament. These articles obligate the Auditor General to provide periodic reports to the Emperor and to Parliament on the financial processes of the government and enabled the Auditor General to get all books and registers relating to government accounts. However, comprehensive functions and reporting necessities were the subjects of later legislation grounded on the endowment of the constitution.

The comprehensive provisions and functions of the office were later revised by Parliament to include further provisions needing the Auditor General to perform before Parliament, when demanded, to clarify the execution of functions delegated to it. The revised legislation has issued a proclamation in 1961. The new proclamation, in addition to describing powers and duties, also proposed settings of appointment and independence of the Auditor General and reporting circumstances. The necessities of this legislation recognized an adequate basis for financial audit exercise but did not deliver a decree for intensifying the scope of the audit to allow the Auditor General to fulfill performance or program assessment audits. However, this was done after the 1974 revolt when proclamation 164/1979 was proclaimed to re-describe the power and duties of the Auditor General. Proclamation 164/79 considerably amplified the previous power and duties of the Auditor General by delegating that efficiency or effectiveness audits be executed. Although this proclamation recognized sufficient basis for the full practices of the legal audit, no extra enhancement was passed to the allowing law of the Office of the Auditor General until the power and duties of the Office of the Auditor General were re-described by Proclamation 13/1987.

The present SAI of Ethiopia was founded by proclamation 68/1997 in sub-article 4 of Article 101 of the constitution. The Auditor General controls the SAI, and it has the power to implement the duties of the office delivered in the proclamation. The Deputy Auditor General straightly assists the Auditor General in planning, organizing, supervising, and coordinating the activities of the office. Seven audit department heads are, which in the responsibility of organizing, coordinating, and supervising the technical components (audit divisions), responsible to the Deputy Auditor General.

1.3. Statement of the Problem

Auditing is a methodical process of objectively finding and assessing evidence concerning statements about economic activities and events to determine the degree of correspondence between statements and established standards and communicating the outcomes to interested parties. Auditing evolved to cater the needs of different users, for instance, it provides unbiased facts regarding actual/potential risks, and effectiveness and inefficiencies of systems and processes for the decision making of management (Russell, 2005). For example, credit and loan officers, as users of audit reports, portray better comprehension of implications of audited financial statements based on their routine exposure to the audit reports and financial statements (Tang & Xiao, 2003). External audit particularly facilitates the implementation of risk management as well as it contributes to the appropriateness of procedures and operations of the audited body (Cohen & Sayag, 2010; Arena & Azzone, 2009; Dittenhofer, 2001).

Hameed (1995), found that the most significant factors that influence auditing efficiency are auditor's experience, honesty, and the knowledge in accounting and auditing standards. Alqam and Alrajabi (1997), in their study in public Jordanian companies, found that auditor rotation is affected by three groups; firm level factors such as management replacement, auditing office particular factors such auditing quality, and factors linked to international auditing principles and auditing ethics. Wong (2001), found that the usage of computer aided audit procedures instead of old-fashioned data mining gives to the achievement of auditing task. Brown, et al. (2006), found that auditor independence does not, by itself, significantly damage the quality of financial information. Khasharmeh, (2002) found that the auditor must be carefully chosen objectively and not grounded on the inter-relationships among the board of directors and the auditor. Preceding researchers recognized a positive association between audit efficiency and some factors like internal control. Further studies have engaged more straight actions, such as the results of quality control, firm scope, audit fees, auditor independence, auditor standing, industry specialty, auditor experiences, and ability.

In African countries like Nigeria auditing is not yet well developing and current reports of doubtful accounting practices engaged by some businesses in Nigeria have carried the matter of audit efficiency to the forefront, and place the auditing profession in a solemn credibility crunch (Otusanya & Lauwo, 2010). A study results made in Nigeria by Uchenna (2011) display that economic reliance on the client, delivery of non-audit services to the client, and rivalry in the audit market are the main factors that weakens the perception of audit efficiency and that this is regular among both sets of respondents. On the other hand, minor audit fees, the risk of a penalty against the auditor, and minor audit fees as a fraction of the firm's total revenues are supposed to improve audit efficiency. A study result made in Kenya by Guandaru (2014) witnessed that audit committees effectiveness plays a substantial role in improving audit efficiency. Organizations may, therefore, reflect constructing capability of the audit committees so as to develop external audit efficiency. The study in advance found out that there is a statistically significant causative link among the level of external auditor's abilities and audit efficiency in Kenya.

Like other African countries, even though the Ethiopian business setting has a long way to drive before it encounters the high standards of the western corporate environments, the toddler private businesses in the economy still necessitate accountants and auditors to accomplish at least portion of the above-mentioned tasks. Here it should be considered that the accountants' obligation also involves an even greater accountability. Some studies are taken in different parts of the world; Naghashiyan (1393) in his article assessed the effect of internal auditor's performance quality on execution time of external audit, Rezaee (1391) in his article scrutinize the impact of internal audit on external audit practice, Pezeshkzade (1391) in his article investigation the dependence of external auditors on various types of internal audit were evaluated, Samavati (1379) in her research investigation the practice of analytical technique, definition value and usage of financial external audit built on small and medium organizations in Iran were taken. Some other studies also focus on audit quality on Small and medium-sized enterprises (Umar, 2011), audit effectiveness on Ethiopian public sector (Dessalegn, 2007), and the usefulness of accounting comparability for audit engagement (Hongbo, 2012). Some other studies were also taken place in the different area of audit practices; however, the problem of efficient employment of external audit engagement on share companies remains an open question. With regard to this, the researcher was attempting to examine the efficiency of external audit engagement and its determinants on Ethiopian share companies. Specifically, the research was considered the following determinants for the efficiency of external audit engagements: internal control, firm size, auditor’s fee, organizational independence, auditor qualifications and proficiency, and auditor’s reputation.

1.4. Research Objectives

1.4.1. General Objectives

The general objective of the study was to examine the efficiency of external audit engagement and its determinants on Ethiopian share companies.

1.4.2. Specific Objectives

Beyond to the general objective of the study, there were some specific objectives which are helpful in order to achieve it. Those specific objectives were;

- ❖ To examine the effect of internal control system on efficiency of external audit engagement.
- ❖ To examine the effect of audit firm size on efficiency of external audit engagement.
- ❖ To examine the effect of organizational independence of external auditors on efficiency external audit engagement.
- ❖ To examine the effect of external auditors qualification and proficiency on efficiency of external audit engagement.
- ❖ To examine the effect of audit fee on efficiency of external audit engagement
- ❖ To examine the effect of external auditor's reputation on efficiency of external audit engagement.

1.5. Research Hypothesis

Internal control is a practice, effected by an entity's board of directors, management, and other personnel, aimed to deliver rational assurance concerning the accomplishment of objectives (INTOSAI: International Organization of Supreme Audit Institutions, 1998). Audit efficiency is achieved by a procedure of identifying and controlling the actions needed to attain the quality objectives of a SAI. Since an entity's internal control is in the purview of its audit committee (Krishnan, 2005), the link between audit committee efficiency, external audit effectiveness and internal control softness is a matter to be studied. The study finds that the internal control system was the critical determinants of audit committee effectiveness and by then to the external audit efficiency through providing a vital monitoring role to assure the quality of financial reporting and corporate responsibility and that will create a road for external audit efficiency. Likewise, Carcello and Neal (2000) in their research finding reveals that level and nature of review procedures, the approach to audit judgments and issues, independent quality control reviews and its approach to risk, critical assessment of the internal control mechanisms of clients, and audit teams and audit committees performance of responsibilities in line with the agreed standards can contribute to the effectiveness of external audit works. Thus, the effective internal control system of both audit firms and share companies have a vital effect on the efficiency of an audit engagement.

H1: Effective internal control system has a positive and significant effect on efficiency of external audit engagement.

The trouble in measuring audit efficiency has directed many researchers to use audit firm size as a proxy. Large audit firms are presumed to accomplish more dominant assessments. As a result, larger audit firms are more probable to be related with more accurate information than are smaller audit firms, all else being the same (Beatty, 1989; Titman and Trueman, 1986). Investigative research has proposed that audit firm size and audit efficiency are positively related. For example, De Angeio (1981), suggests that larger firms deliver higher-quality audits since larger audit firms have fewer inducements to compromise their standards to ensure the preservation of clients in contrast with smaller firms. Likewise, Dopuch and Simunic (1982), debate that audit efficiency is a function of the amount and degree of audit processes accomplished by the auditor and that larger firms have more capitals with which to perform assessments, Moore and Scott (1989), reveal systematically that audit firm size and the magnitude of audit work are positively related. In their study the size of external audit firms was measured in terms of the probable to be related with more accurate information; inducements to compromise standards to ensure the preservation of clients, and amount and degree of audit processes accomplished by the auditor and capitals with which to perform assessments.

Furthermore, Krishnan and Schauer (2000), studied the relationship between auditor size and audit efficiency for a sample of not-for-profit organizations. Their audit efficiency measure was built on the entity's obedience with GAAP reporting requirements. Audit firms were alienated into three groups: Big Six, large non-Big Six and small non-Big Six. They initiate that obedience improved as one progressed from the small non-Big Six to large non-Big Six and from the large non-Big Six to Big Six. They also verified the auditor size–audit efficiency linkage with a more continuous assessment of audit firm size: the number of professionals working for audit firm and this test further confirmed their outcome. Thus, audit firm size and audit efficiency are positively related according to the prior studies.

H2: Size of external audit firms has a positive and significant effect on efficiency of external audit engagement.

An independent audit committee improves the impartiality of external auditor, and make sure that auditor is free from management impact. The committee can perform informal and private summits without the attendance of the company's management to inspire the external auditor to be clear on valuable matters at an early phase. The best-recognized explanation of independence in academic literature is De Angelo (1981), the uncertain likelihood of reporting a discovered breach; others comprise an outlook/state of mind Schuetze (1994); a function of acting with the truthfulness and honesty being vital Magill and Previts (1991). Geiger and Raghunandan (2002), proposed that auditors with longer tenancy are more probable to be independent, and are steady with Myers et al. (2003) in that elongated auditor tenancy is related to the higher worth of reported earnings. This implies that auditors with higher audit efficiency (i.e., auditors independent) are more probable to fight back client management forces than auditors with lower audit efficiency. The organizational independence were measured in terms of interference and influence of auditing activities; auditors freedom to decide the scope, time and extent of auditing procedures based on auditing standards; auditors access to necessary documents, information and data about the organization/sector for their audit work; auditors freedom to include any audit finding in their audit work and report directly to responsible body; and auditors efficiency to probably fight back client management forces. These studies were observed auditor independence in auditor-client cooperation over financial reporting matters, and whether highly efficient auditors are more likely than least efficient auditors to fight back client management forces in auditor-client cooperation over financial reporting matters. Currently, financial disgraces at firms such as Enron and WorldCom have worn out public confidence in the independence of the accounting profession and the efficiency of audit services.

H3: Organizational independence has a positive and significant effect on efficiency of external audit engagement.

The focal drive of the audit is to assure outsiders that the financial statements are free from valuable misstatements, the significance of an audit be contingent on the outsiders' ex-ante insight of the likelihood that the auditor will ascertain the ruptures or mistakes in the reporting system and on the likelihood that the auditor will report the revealed ruptures or mistakes (De Angelo, 1981). Many investigate discover that there is a positive relationship between audit efficiency and the auditor qualifications and proficiency. For example, Sundgren (1998) initiate that non-certified auditors are less probable to adapt the audit report, which advocates that non-qualified auditors deliver lower assurance than qualified auditors. Simunic and Stein (1987) proposed that though auditor moral hazard has received raid consideration in the academic literature, it is supposed to be predominantly serious in the government setting. The auditors' qualification and proficiency were measured in terms of sufficient skilled external auditor and certification in auditing; audit team members responsive to clients' requests and their consistency; on time completion of audit procedures and evidence collections; audit team members sufficient industry experience and understanding of clients' business and its issues; and level of strength of audit team to works together effectively. In this atmosphere, the likelihoods of client financial failure and resultant ex-post exposure of lower-than-implied audit efficiency are slight. Thus, there is a need for alternative mechanisms for enhancing the credibility of the audit. Mutually the General Accounting Office GAO (1987) and the American Institute of Certified Public Accountants AICPA (1987) sight proper audit attaining practices as a tool for safeguarding that the contracted audit efficiency is in fact provided.

H4: External auditor's qualification and proficiency have a positive and significant effect on efficiency of external audit engagement.

Audit fees refer all charges that the companies pay to the external auditors against for the audit services and non-audit services, e.g. management consultative and advisory. Auditing fees comprise primarily of the salaries and benefits of office and field workers, transport costs, and other costs necessary to the audit and associated support undertakings. The fees equivalent the projected cost of staff time and the real cost of travel for those undertakings, plus a margin of profit. In their argument of Kinney and Libby (2002), proposed that the danger to auditor independence could be as robust when the audit fee is huge. Numerous investigations that have empirically studied the association between audit efficiency and audit fee; Francis and Simon (1987), thinking that audit services are quality-differentiated and that in a competitive market, quality variances are replicated in charges. However, since audit fees have a number of determining factors, they are a raucous proxy for efficiency. A preceding study which studies whether, in an Australian situation, the presence of an audit committee, audit committee features and the use of internal audit are related with a greater level of audit fees determines that a higher audit fee indicates higher audit efficiency (Francis, 2004). The study was measured the audit fee in terms of the appropriateness of the audit fee given the scope of the external audit; danger to auditor independence; and discussion made for the level of outstanding fees with the audit committee and payment of such fees before the report is issued. Several writers debated that managers and entrepreneurs are ready to pay higher audit fees to obtain what are seeming to be higher audit efficiency.

H5: Audit Fee has a positive and significant effect on efficiency of external audit engagement.

An auditor's reputation is positively linked to the perceived and definite levels of efficiency replicated by the auditor's report. Choi and Jeter (1992) revealed a narrowed stock market reaction to earnings reports when a qualified opinion is handed out. If auditor quality is endangered, the audit report delivers a lower level of assertion to the users of financial reports that the financial reports imitate the firm's business actuality and a higher likelihood that its earnings and book values have been inflated lacking being identified by its auditor. Accordingly, they studied Arthur Andersen's clients' stock market influence adjacent dates on which Andersen's audit processes and independence were under severe examination as well as Andersen's clients' auditor shift dates. A high-quality job momentously raises the likelihood that audit outcomes will depend on and suggested enhancements will be extremely considered and applied.

H6: External auditor's reputation has a positive and significant effect on efficiency of external audit engagment.

1.6. Significance of the Study

The research was targeted to examine the efficiency of external audit engagement and its determinants on Ethiopian share companies. By having this research, the researcher believes that, it can be deliver as an input to the management of those sector companies what kind of role external audit has on the company's performance since it has a vital contribution to making sound decisions in the company and to identify their weakness based on the study, and improve their current systems, by strengthening the role of external audit in the company. Furthermore, the study is determining and give an insight into the efficiency of external audit engagement in Ethiopian share companies. In addition to this, the result of the study is believed to be used as a starting point for other researchers for their further study.

1.7. Scope and Limitations of the Study

There are many business organizations in the country and within those forms share companies are included and they are operating in order to achieve their business objectives. Thus, because of auditor's opinion are the backbone for various decisions made by those company's management and external groups while dealing with different important analysis, the auditors of the audit firm were given more emphasis while going through the study. Furthermore, the intent of this study is to examine the efficiency of external audit engagement through the selected determinants of it; such as effective internal control, firm size, organizational independence, auditors' qualification and proficiency, audit fee, and auditor's reputation on audit firms operate in Ethiopia.

1.8. Organization of the Paper

The research consists five separate chapters. The first chapter is an introduction part that shows and explains the background of the study, statement of the problem, the objective of the study, scope, and limitations of the study which is going to be studied. The second chapter presents a literature review, which contains information, ideas, data, and evidence written from a particular standpoint to fulfill certain aims or express certain views on the nature of the topic and how it is to be investigated, and the effective evaluation of those documents relation to the research being proposed. The third chapter is research methodology, which specifies methods and procedures used for collecting and analyzing the needed information in order to assess the research problem. The fourth chapter is about data presentation, analysis, and discussion. It is the core of the research in which the data presentation, data analysis, and results, and discussion of results were performed. The last but not the least chapter presents the summary of major findings, conclusions, and recommendations made by the researcher.

CHAPTER TWO

2. LITERATURE REVIEW

Auditing has created great progress in the previous decade, but it has not apparently kept bound with the real-time economy. Certain auditing methods and procedures that were significant in the past now a day seems old-fashioned. Also, the auditing progress has reached a serious juncture whereby auditors may either lead in encouraging and accepting the future audit or proceed to adhere to the more traditional pattern in some fashion. Future audit styles would probably involve auditors, regulators, and standards setters to settle substantial modifications as accounting experiences an essential role in our economic and societal structure. Sound decisions made by individuals, businesses, governments and other entities are essential for the efficient distribution and use of the nation's scarce resources (Weygandt, 1993). To make such decisions, these groups must have reliable information provided by the accounting system. As a result, the critical assessment of the system which is accounting system is needed and external auditing is the basic tool for assessing the applicability of it.

Furthermore, there is a necessity for auditing when ownership is alienated from control. At a concrete level, it supports to prevent or identify misstatements-errors or fraud. It may possibly prevent or identify misstatements on the part of (1) the employees who essentially handle the money, or (2) management. Auditing is necessary to improve the trustworthiness of financial figures prepared by an entity. The independent audit necessity satisfies the need to make sure that those financial statements are impartial, free from bias and manipulation and significant to the desires of users (Arens, 2012).

The objective of the regular investigation of financial reports by the auditor is an expression of an opinion on the fairness of the financial reports. It is usual in the audit to pinpoint audit objectives for the audit in wide-ranging and for each account stated in the financial reports. These purposes are resulting from management’s assertions (Arens, 2012). The auditor’s objectives are nearly linked to management assertions. Audit objectives are planned to deliver a framework to support the auditor accumulate adequate and competent evidence requisite by the third standard of fieldwork and decide the appropriate evidence to accumulate assumed the conditions of the engagement.

This chapter provides the readers an insight into the different existing theories related to the study regarding factors affecting external audit effectiveness. This chapter will help the readers in understanding the concepts related to this study, along with developing their knowledge regarding what opinions different researchers and authors hold regarding the topic of research. Similarly, this chapter would help the author of this study in a way that it will provide me with a platform on the basis of which I will proceed further. The interview guide for this research study will be based on the literature reviewed in this chapter, and finally, the analysis and conclusion of this study would be based on it as well.

2.1. Theoretical and Conceptual Literature

The primary reason for the development of auditing profession is the need of attest function. That is the need of Independent assurance of the reliability, credibility, and quality of Information. When certified public accountants attest to information they issue a report with a conclusion about the reliability of a written assertion by management. In the case of financial statement audits, the audit report, for the most part, contains an opinion regarding whether management's financial statements conform to generally accepted accounting principles (GAAP). Auditors also are being asked to assume more responsibility for attesting to compliance with laws and regulations, and to the effectiveness and Internal controls (Eliffson, 2006).

2.1.1. Auditing and Audit Related Concepts

The American Accounting Association, Committee on Basic Auditing Concepts identified auditing as a systematic process of accurately obtaining and assessing figures concerning statements about economic activities and actions to determine the degree of correspondence among affirmations and established standards and communicating the outcomes to interested parties. The expressions in this description require further explanation. The expression systematic process indicates there should be a carefully planned approach for performing an audit. This plan encompasses objectively getting and assessing evidence. The evidence collected by the auditor must link to statements about economic activities and actions (Eliffson, 2006). For example, financial statements set by management encompass several assertions. The auditor relates the evidence collected to affirmations about economic action in order to evaluate the degree of correspondence between those affirmations and recognized criteria (Sarasota, 1973). Generally

Accepted Accounting Principles (GAAP) is generally used for evaluating the degree of correspondence, for financial audits. The last expression, communicating the outcomes to interested parties, is linked with the kind of report the auditor delivers to the envisioned users such as Banker, Investors, Stockholders, Creditors, etc. (Eliffson, 2006).

There are many reasons that make different groups have a demand on the audit. The essence of demand for audit refers to the question “why do organizations request an audit?” the answer to this question can be described as the following: Firstly, for control mechanism as audits whether important control mechanisms for accountability. The auditor’s role is determining whether the reports prepared by management are in conformity with the responsibility and duties provided in the organization policies. The overall need for monitoring activities, need demands (requests) auditing to provide credible or audited financial information, Audited performance reports, audited implementation of rules, & regulations.

Secondly, the demand for audit is to resolve the conflict of interest between management and the owners. The Agency relationship that exists between the owner and manager produces a natural conflict of interest because; the manager has more information about the true financial position and results of operations of the entity than the owner who is absent. It both parties seeks to maximize their own self-interest, it is likely that the manager will not act in the best interest of the owner. Example, the manager may spend organizational funds to provide excessive personal benefits or manipulate the reported earnings in order to earn a larger bonus. Thus, the need for independent (non-partial) opinions or view is necessary to resolve such conflicts.

Thirdly, auditing is used to reduce damaging consequences. Even though, the function of accounting is to provide information for economic decision making; this information must be verified by auditors before they are used for decisions that have serious and subsequent actual economic consequences.

Fourthly, the audit is demanding to simplify complexity. In our age, financial information& translation has come complex in preparation, content, and format. Therefore it demands drippy specialized body of knowledge to prepare (compilation), verify and interpret them. Lastly, the audit is used for regulatory requirements as many business laws, memo random of association and government regulation, make requirements’ annual audits. For Example, for renewal of a license, or permit, (commercial code to Ethiopia), financial administration regulation proclamation tax, requires audited financial statement (Senait, 2003).

Though there are several types of audit on the basis of explanations previously provided, normally they are discussed in three categories; financial statement audits, compliance audits and operational audits. The purpose of a financial statement audit is to determine whether the overall financial statements present fairly in accordance with specified criteria. This type of audit usually covers the basic set of financial statements (Balance Sheet, Income statement, statement of stockholders equity, and statement of cash flows); and Generally Accepted Accounting Principles (GAAP) serve as the criteria(Sarasota, 1973).

However, some financial statements audits may consider other standards, such as cash basis or income tax basis. Whereas the function of a compliance audit is to assess and evaluate the degree to which rules, policies, lawful agreements, or governmental bylaws are tailed by the entity being audited, for example, a company might use auditors to evaluate whether the corporate rules and policies are being tailed by divisions within the organization. The corporate rules and policies work as the standards for evaluating the division's compliance (Shockley, 1981). An additional example is an investigation of tax payment of individuals and firms by the Internal Revenue Service for compliance with Tax Regulations.

Lastly, operational audit encompasses a systemic assessment of organizational actions, or a part of them, in connection with the efficient and effective usage of assets. The importance of operational audit is to evaluate performance, identify extents of enhancement, and make recommendations. Occasionally, this kind of audit is denoted as a performance audit or management audit. Operational audits are normally more challenging to engage than financial and compliance audits. Since the target of an operational audit is to assess effectiveness and efficiency, it can be very challenging to pinpoint objective, assessable criteria that can be used for that purpose. Examples, of such audit, include an audit of government programs, the efficiency of the Food and Drug administration's procedures for Introduction of new Drugs to market, assessment of the efficiency and effectiveness of organizations use of computer resources, etc.(Aami & Farooq, 2011).

2.1.2. External Audit and Internal Control

As stated by AICPA (American Institutes for certifications of public accountants), internal control refers to all coordinate methods and measures within an organization or within a system adopted to safeguard assets, cheek accuracy and reliability of accounting data, promote operational efficiency and encourage adherence to prescribed managerial policy. The purpose of internal control on the auditor's concern as the generally accepted auditing standard field work standard, number three (3) states that a sufficient understanding of internal control is to be obtained to plan the audit and determine the nature, timing, and extent of tests to be performed. Thus, the primary purpose of studying and evaluating the internal control system by external auditors is to determine the amount of audit work. It is assumed that good internal control provides more reliable financial data and statements as one of the objectives internal control is to control financial reports i.e., to ensure the preparation of reliable financial statements(Shockley, 1981).

2.1.3. Agency Theory and Audit Quality

Auditing plays a vital role in reducing both: information asymmetry by empirically confirming the validity of financial statements and agency problems. The principal-agent conflict illustrated in agency theory, where the principal (owner) lack reasons to believe their agents (managers) because of information asymmetries and contradictory motives. Information asymmetry deals with the study of decisions in transactions where one party has more or superior information than other. The contradictory motives such as financial rewards, labor market opportunities, and associations with other parties that are not directly related to principals can, for example, the consequence for agents to be more optimistic about the economic performance of an entity rather than a performance of the whole company (Eliffson, 2006). Differing motivations and information asymmetries decrease the reliability of information, which cause a breach of trust that principals will have on their agents. Therefore auditors as a third party used to try to align the interests of agents with principals and to let principals gauge and manage the behavior of their agents and strengthen trust on agents. This, however, brings a new concept of auditors as agents, which leads to a breach of trust, threats to objectivity and independence.

When auditors perform an audit they are acting as agents for principals and this liaison, therefore, raising similar issues of trust and confidence as the director-shareholder relationship, prompting questions about who is auditing the auditor. Agents (either directors or auditors) may be trustworthy without further incentives to align interest or monitoring strategies such as audits or increased regulations. However, the simple agency model would recommend that agents are untrustworthy because managers, auditors will have their own interests and motives. Independent auditor from the board of directors is of huge importance to shareholders and a key factor to deliver high audit quality. However, an audit obliges a close working relationship with the board of directors of a company. The fostering of this close relationship has led question mark on the independence of auditors and ultimately question mark on audit quality (The Institute of Chartered Accountants in England & Wales, 2005).

2.1.4. International and U.S Auditing Standards

Auditing standards are overall guiding principles to help auditors in accomplishing their professional duties in the audit of historical financial statements. They comprise reflection of professional qualities such as competence and impartiality, reporting requirements, and evidence. The three core sets of auditing standards are International Standards on Auditing, U.S. Generally Accepted Auditing Standards for bodies other than public companies, and PCAOB Auditing Standards (Arens, 2012).

2.1.4.1. International Standards on Auditing (ISA)

International Standards on Auditing (ISAs) are delivered by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). IFAC is the international organization for the accountancy occupation, with 159 member organizations in 124 countries, in lieu of more than 2.5 million accountants all over the world. The IAASB works to develop the consistency of auditing practices and associated services all over the world by delivering pronouncements on a range of audit and attest functions and by upholding their recognition worldwide (Arens, 2012).

International Standards on Auditing (ISA) deals with the overall objectives set out for an independent auditor with its nature and scope allowing the independent auditor to meet these objectives in terms of conducting the audit of financial statements. The intended users audit financial statements on certain standards in order to enhance the degree of confidence over the financial statements. This is done in a way that the auditor provides an opinion regarding the trueness and fairness of financial statement in comparison with certain financial reporting framework that does the financial statements with all the material aspects of the framework (IFAC, 2010). ISA neither imposes responsibility for the management nor on those responsible for the governance in an entity and ISAs also do not supersede the laws and regulations in that entity for the governance and responsibilities. Before the issuance of an audit opinion, the auditor is required by ISAs to confirm the reasonable assurance, which is the high-level assurance but not the absolute assurance, that the financial statements as a complete package are free from material errors either due to fraud or error. ISA provides the support to the auditors in order to help them in obtaining the reasonable assurance in accordance with the objectives, requirements, and applications designed and presented in ISA.

What is required by ISA from the auditors are: to enforce professional judgment along with maintaining professional skepticism while planning and performing the audit; Identification and assessment of the risks associated with material misstatement either due to fraud or error, according to the comprehension of the entity and its environment; for the response to the assessment of the risk, sufficient and appropriate evidence should be sought regarding the existence of material misstatements; drawing conclusion in the form of an audit opinion regarding the financial statements based on the audit evidences obtained (IFAC, 2010).

Apart from the aforementioned responsibilities, an auditor might have certain responsibilities in terms of communicating and reporting results to the users, management, and to the stakeholders both inside and outside the entity. ISA suggests that an auditor should either disclaim or withdraw itself from the engagement if the auditor is unable to acquire a qualifying or justifiable opinion regarding the financial statements or the obtained results are insufficient for the purpose of reporting them to the intended users. Audit evidence which refers to the information used by the auditors in order to reach a certain conclusion on the basis of which audit opinion is formulated. Audit evidence is formulated on the basis of information from both the accounting records in the financial statements and the other information concerning the entity. For the purpose of ISA, audit evidence is evaluated on two criterion such that both on the basis of quantity and quality of audit evidence (IFAC, 2010). The quantity of audit evidence provides the sufficiency of audit evidence needed to affect the assessment of auditor regarding the risks of material misstatements, while the quality of audit evidence provides the relevance and reliability of it in terms of supporting the conclusions drawn from the audit opinion. Associated with the audit evidence is the audit risk, which refers to the risk that the auditor would present an unfitting audit opinion concerning the financial reports which are significantly misstated. This audit risk is a function of material misstatements risk and detection risk. Where detection risk refers to the risk involved in the procedures conducted by an auditor in order to reduce the audit risk would to an acceptably low level not be able to detect a misstatement that exists and that could be material on the basis of individuality or in combination with other misstatements (IFAC,2010).

The risk of material misstatements refers to the risk that the financial statements are materially misstated prior to the audit. This has been classified into two components which are the inherent risk and the control risk. Inherent risk refers to the susceptibility of an assertion in the financial statements item in terms of class of transaction, account balance or disclosure to a material misstatement either in its individual presence or in aggregation with other material misstatements before driven under any related controls. Whereas control risk refers to the risk that a material misstatement that could be present in an assertion about a class of transaction, account balance or disclosure either individually or when aggregated with other misstatements, could not be avoided, or detected and corrected, on a timely basis by the internal control of an entity.

The misstatement which has been often used refers to the difference between the amount, classification, presentation, or disclosure of a financial statement item being reported and the amount, classification, presentation, or disclosure that was required for the financial item to be in accordance with the identified financial reporting framework. Professional judgment that is required in an audit by the IAS refers to the application of relevant training, knowledge and experience in an audit engagement within the specified context of auditing, accounting and ethical standards, in a way to smoothen the economic decision making regarding the courses of action that are feasible to the circumstances of the audit engagement. Whereas the professional skepticism in an audit refers to the attitude of an auditor in accordance to their questioning of mind, being alert to conditions which may provide any signs of possible misstatement due to error or fraud, and a critical assessment of audit evidence (IFAC,2010).

An auditor needs to comply with the relevant ethical requirements such as independence, integrity, objectivity, professional competence and due care, confidentiality and professional behavior as identified by International Ethics Standards Board for Accountants (IESBA), relating to financial statement audit engagement. According to IESBA Code, independence is described as both independence of mind and independence in appearance. The independence of the auditor from its client tends to safeguard the abilities of an auditor to formulate an audit opinion without being affected by any pressures and influences that could lead to a compromise over the opinion. This auditor independence improves an auditors' ability to engage with integrity, to be objective and to maintain an attitude of professional skepticism. For the critical assessment of audit evidence, it is necessary to have professional skepticism. This refers to the questioning of audit evidence which is contradictory and the reliability of documents and responses to inquiries along with other information acquired from management and the ones responsible for governance. The auditor rules cannot be expected to disregard the past experiences of honesty and integrity of an entity's management and the ones responsible for the governance (IFAC, 2010). For auditor's opinion and reporting it is necessary that it should be supported by the audit evidence. This audit evidence is obtained via audit procedures performed during the audit engagement and are cumulative in nature.

Other information sources which could contribute towards the audit evidence include information obtained from previous audits such as identification of the changes by the auditor that could have occurred since the previous audit and which could affect the current and be relevant to it. A firm's procedures for quality control in terms of accepting and continuing with the clients could be another source which could form the basis of audit evidence. Apart from this, the accounting records of an entity are also important contributors towards audit evidence. In certain cases, the absence of information or managements' refusal to provide the requested information could be used by the auditor as audit evidence. The sufficiency and appropriateness of audit evidence are interrelated and are measured via the quantity of audit evidence and quality of audit evidence, respectively. An auditor needs to perform the audit engagement both in accordance with the ISAs and the auditing standards of a particular jurisdiction or country (IFAC, 2010).

In the case of recurring audits, the auditor should assess the circumstances under which the terms of audit engagement are required to be revised, and check if there exists a need to remind the entity regarding the existing terms of the audit engagement. But terms of engagement should not be changed until and unless there is no reasonable justification for doing so. Both the auditor and the management of the entity shall agree upon the changes into the terms of the audit engagement, and should form a written agreement. Quality control procedures should be taken into consideration during the audit engagement level which could provide the auditor with reasonable assurance regarding the compliance of audit with the professional standards and applicable legal and regulatory requirements; and report issued by the auditor is under appropriate circumstances. The engagement partner should remain alert throughout the audit engagement by making necessary observations and inquiries in order to check for evidences of non-compliance with relevant ethical requirements by members of engagement team on the basis of which the audit partner in consultation with other could determine the appropriate action in case of failure by the engagement team to comply with the ethical requirements (IFAC, 2010).

ISAs do not dominate a country's conventions governing the audit of financial or other figures, as every country's own regulations usually govern audit practices. These guidelines may possibly be either government statutes or announcements delivered by regulatory or professional organizations, such as the Australian Auditing & Assurance Standards Board or Spain's Instituto de Contabilidady Auditoría de Cuentas. Many nations, comprising the United States, base their auditing standards on ISAs, adjusted as proper for each country's regulatory setting and legal requirements (Arens, 2012).

The Auditing Standards Board in the U.S. has reviewed most of its standards to congregate with the universal standards. In addition, the PCAOB considers prevailing international standards in evolving its standards. As a result, U.S. standards are mostly steady with international standards, with the exception of certain requirements that replicate distinctive characteristics of the U.S. setting, such as legal and regulatory requirements. For example, PCAOB Standard 5 (AS 5) discourses audits of internal control over financial reporting requisite by the Sarbanes –Oxley Act (Arens, 2012).

2.1.4.2. U.S. Generally Accepted Auditing Standards

Auditing standards for private firms and other bodies in the United States are recognized by the Auditing Standards Board (ASB) of the AICPA. These principles are referred to as Statements on Auditing Standards (SASs). According to Arens (2012), these Generally Accepted Auditing Standards (GAAS) are alike to the ISAs, although there are certain variations. If an auditor in the United States is auditing historical financial statements in accord with ISAs, the auditor must encounter any ISA requirements that spread out beyond GAAS. Preceding to the passage of the

Sarbanes–Oxley Act, the ASB recognized auditing standards for private and public corporations. The PCAOB now has a duty for auditing standards for public companies, while the ASB stays to provide auditing standards for private companies and other bodies.

2.1.4.3. Public Company Accounting Oversight Board (PCAOB) Auditing Standards

The PCAOB originally adopted prevailing auditing standards recognized by the ASB as interim audit standards. Furthermore, the PCAOB contemplates international auditing standards when evolving new standards. Consequently, auditing standards for U.S. public and private companies are typically alike. Standards delivered by the PCAOB are referred to as PCAOB Auditing Standards in the audit reports of public corporations and apply merely to the audits of public companies (Arens, 2012).

Generally, international auditing standards as approved by standard-setting organizations in different countries apply to audits of entities out of the United States. Generally accepted auditing standards are alike to international auditing standards and put on to the audits of private corporations and other entities in the United States. PCAOB auditing standards put on to audits of U.S public firms and other SEC registrants.

2.1.5. Generally Accepted Auditing Standards (GAAS)

The widest guiding principles accessible to auditors in the U.S. are the 10 generally accepted auditing standards (GAAS), which were established by the AICPA. The 10 generally accepted auditing standards divide into three classifications: General standards, standards of fieldwork, and reporting standards (Arens, 2012).

The general standards pressure the significant personal qualities that the auditor should have. Adequate Technical Training and Proficiency is the first general standard. It is usually understood as requiring the auditor to have official education in auditing and accounting, sufficient real-world experience for the work being accomplished, and persistent professional education (Arens, 2012). Current court cases undoubtedly show that auditors must be technically qualified and experienced in those businesses in which their audit clients are involved. In any case, in which the CPA or the CPA’s subordinates are not experienced to accomplish the work, a professional obligation exists to obtain the required knowledge and skills, advocate someone else who is qualified to execute the work or drop the engagement. The second general standard is Independence in Mental Attitude.

The Code of Professional Conduct and SASs pressure the necessity for independence. CPA firms are requisite to keep an eye on several practices to raise the likelihood of independence of all workforces. For example, there are developed techniques on larger audits when there is a disagreement between management and the auditors (Arens, 2012). The third general standard is Due Professional Care. It implicates due care in the enactment of all features of auditing. Basically, this means that auditors are professionals liable for accomplishing their responsibilities diligently and carefully. Due care comprises contemplation of the wholeness of the audit documentation, the adequacy of the audit evidence, and the appropriateness of the audit report. As professionals, auditors must not perform carelessly or in bad faith, but they are not anticipated to be infallible (Arens, 2012).

The standards of field work concern evidence gathering and other undertakings during the actual work of the audit. Adequate Planning and Supervision is the first field work standard. It involves that the audit is adequately planned to ensure an acceptable audit and appropriate supervision of subordinates. Supervision is vital in auditing for the reason that a substantial share of the field work is done by less qualified staff members. Understand the Entity and its Environment, Including Internal Control, is the second field work standard. To sufficiently accomplish an audit, the auditor must have a clear understanding of the client’s business and industry. This understanding aids the auditor pinpoint important client business risks and the risk of significant misstatements in the financial statements (Arens, 2012). For example, to audit a bank, an auditor must know and understand the environment of the bank’s operations, federal and state regulations applicable to banks, and risks affecting substantial accounts such as loan loss reserves.

One of the most extensively recognized notions in the theory and practice of auditing is the significance of the client’s system of internal control for justifying client business risks, protecting assets and records, and making trustworthy financial information. If the auditor is persuaded that the client has an admirable system of internal control, one that includes adequate internal controls for delivering reliable data, the extent of audit evidence to be gathered can be considerably less than when controls are not sufficient. In some cases, internal control may be so insufficient as to prevent accompanying an effective audit. Sufficient Appropriate Evidence Decisions is the third field work standard. Sufficient appropriate evidence decisions regarding how much and what types of evidence to gather for a specified set of conditions need professional judgment (Arens, 2012).

The four reporting standards require the auditor to make a report on the financial statements considering as a whole, containing informative disclosures. The reporting standards likewise require that the report state whether the statements are presented in accord with GAAP and also pinpoint any conditions in which GAAP have not been reliably applied in the present year compared with the preceding one (Eliffson, 2006).

2.1.6. Quality Control for CPA Firms

For a CPA firm, quality control encompasses the techniques used to certify that the firm encounters its professional duties to clients and others. These approaches include the organizational structure of the CPA firm and the procedures the firm develops. For instance, a CPA firm might have an organizational structure that certifies the methodological assessment of every engagement by a partner who has proficiency in the client's industry. Auditing standards need each CPA firm to develop quality control policies and procedures. The standards identify that a quality control system can deliver only rational assurance, not a guarantee, that auditing standards are shadowed (Eliffson, 2006).

The system of quality control ought to include policies and procedures that state six elements (Arens, 2010). Leadership responsibilities for quality within the firm ("tone at the top") are the first element and it stresses firm should encourage a culture that quality is vital in executing engagements and should create policies and procedures that support that culture. Relevant ethical requirements are the second element and it states that all personnel on engagements should preserve independence in fact and in appearance, accomplish whole professional duties with integrity, and preserve objectivity in carrying out their professional duties.

Acceptance and Continuation of clients and engagements are the third elements. It states policies and procedures should be established for determining whether to continue a client relationship. These policies and procedures manage should reduce the risk of relating with a client whose management absences integrity. The firm should also only carry out engagements that can be accomplished with the professional capability (Arens, 2010). Human resources is the fourth element and it stresses policies and procedures should be developed to deliver the firm with rational assurance that; all new personnel should be qualified to accomplish their work proficiently, work is allotted to personnel who have sufficient technical training and proficiency, all personnel should take part in persistent professional education and professional improvement undertakings that allow them to achieve their allotted responsibilities, and personnel designated for development have the qualifications essential for the fulfillment of their allotted duties. Engagement performance is the fifth element and it states policies and procedures should exist to ensure that the work achieved by engagement personnel encounters appropriate professional standards, regulatory requests, and the firm's standards of quality. Monitoring is the final element and it states that policies and procedures should maintain to ensure that the former quality control elements are being effectively practiced (Arens, 2012).

2.1.7. Objective of Conducting an Audit of Financial Statements

Our main emphasis is the section that stresses delivering an opinion on financial statements. For certain public companies, the auditor as well issues a report on internal control over financial reporting as requisite by Section 404 of the Sarbanes–Oxley Act. Auditors gather evidence in order to make conclusions regarding whether the financial statements are fairly presented and to decide the effectiveness of internal control, after which they issue the proper audit report (Arens, 2012).

According to Eliffson (2006), if the auditor believes that the statements are not fairly stated or is incapable of making a conclusion for the reason that inadequate evidence, the auditor has the duty of informing users over the auditor's report. Following to their issuance, if evidence shows that the statements were not fairly stated, the auditor will most likely have to demonstrate to the courts or regulatory agencies that the audit was accomplished in an appropriate way and the auditor reached rational conclusions.

According to (Arens, 2012), auditors has responsibilities for identifying material errors. Auditors devote a great share of their time planning and performing audits to identify unintentional mistakes made by management and employees. Auditors find a range of errors subsequent from such things as errors in calculations, oversights, misunderstanding, and misapplication of accounting standards, and improper summarizations and explanations. Auditors have also responsibilities for detecting material fraud. Auditing standards create no difference among the auditor's responsibilities for searching for errors and fraud. In both cases, the auditor must get reasonable assurance regarding whether the statements are free of substantial misstatements. The standards as well are familiar with that fraud is frequently more challenging to identify since management or the employees committing the fraud try to hide the fraud. Still, the difficulty of identification does not alter the auditor's duty to appropriately plan and accomplish the audit to identify material misstatements, whether caused by error or fraud. Auditors have responsibilities for discovering illegal acts. Illegal acts can be defined as abuses of laws or government regulations other than fraud. Two instances of unlawful acts are an abuse of federal tax laws and a violation of the federal environmental protection laws (Eliffson, 2006).

According to Arens (2012), auditors have three stages of responsibility for identifying and reporting unlawful acts. Firstly, evidence gathering when there is no reason to believe indirect-effect illegal actions exist. Many audit procedures usually achieved on audits to search for errors and fraud may also discover illegal doings. Examples comprise reading the minutes of the board of directors and questioning of the client's lawyers about litigation. The auditor should also ask management regarding policies they have developed to foil illegal acts and whether management knows of any laws or regulations that the company has violated. Other than these procedures, the auditor should not explore for indirect-effect illegal actions unless there is a reason to believe they may possibly exist.

Secondly, evidence gathering and other activities when there is a reason to believe direct- or indirect-effect illegal acts may exist. The auditor may discover signs of probable illegal acts in a range of ways. For instance, the minutes may show that an examination by a government agency is in the process or the auditor may have stated abnormally large payments to advisors or government officials (Arens, 2012).

Thirdly, actions when the auditor identifies of an illegal act. The first course of action when an illegal act has been known is to ponder the sound effects on the financial statements, comprising the sufficiency of disclosures. These effects may be complex and challenging to resolve. For instance, a violation of civil rights laws could encompass substantial fines, but it could also upshot in the cost of customers or significant employees, which could substantially affect future revenues and expenses. If the auditor accomplishes that the disclosures relation to an illegal action is insufficient, the auditor should adjust the audit report in view of that. The auditor should also think through the influence of such illegal acts on the CPA firm's relationship with management. If management identified of the illegal doing and miscarried to notify the auditor, it is doubtful whether management can be trusted in other discussions (Arens, 2012).

According to Eliffson (2006), the auditor ought to communicate with the audit committee or others with corresponding authority to make sure that they know of the unlawful act. The announcement can be oral or written. If it is oral, the nature of the announcement and dialogue should be documented in the audit files or records. If the client either rejects to accept the auditor's adjusted report or miscarries to take proper corrective action regarding the illegal act, the auditor may possibly find it essential to take out from the engagement. If the client is publicly held, the auditor also ought to report the matter straight to the SEC. Such judgments are multifaceted and usually consist of consultation by the auditor with the auditor's legal counsel (Arens, 2012).

2.1.8. Development of Auditing

Auditing has created great progress in the previous decade, but it has not apparently kept bound with the real-time economy. Certain auditing methods and procedures that were significant in the past nowadays seem old-fashioned. Also, the auditing progress has reached a serious juncture whereby auditors may either lead in encouraging and accepting the future audits or proceed to adhere to the more traditional pattern in some fashion. Future audit styles would probably involve auditors, regulators, and standards setters to settle substantial modifications. Such adjustments might include changes in the timing and frequency of the audit, increased education in technology and analytic methods, adoption of full population examination instead of sampling, re-examination of concepts such as materiality and independence, and mandating the provisioning of the audit data standard (Solomon, Shields, &, Whittington, 1999). Auditors would require having significant technical and systematic skills that are presently not constituents of most old-fashioned four-year university accounting curriculums.

Traditionally, following the early formation of a pledged arrangement among the auditor and auditee, an audit engagement normally continues with a risk evaluation and construction of an audit blueprint describing the scope and purposes of the audit. Succeeding this, auditors gather and examine audit evidence and form opinions relating to internal controls as well as trustworthiness of the information delivered by management. At the engagement end point, auditors prepare and present an official report stating their opinion (Aami & Farooq, 2011). In fact, this tactic replicates the twentieth-century approaches whereby there are high costs and substantial time delays related to information gathering, processing, as well as reporting. However, these historic costs and postponements are normally not the norm today. Most probably, in the present business kingdom, business transactions are usually entered and accumulated such that they can deliver near prompt response to significant stakeholders. Besides, academicians and experts similarly know this information transferable and established various solutions that more properly replicate the present business atmosphere.

In computerizing the audit, organizations traditionally familiarized to manual audit processes may worth from following the future audit in an incremental way. Such an attitude would fundamentally result in performing a pilot study to determine the possible advantages of audit mechanization. Because opposition to modification is a common phenomenon, continuing and cautious improvement will probably be a more manageable method. Moving onward, this might eventually product in better successive support for the extension of automated audit performances and programs and could considerably develop the likelihoods of success in ultimately attaining the future audit. Lanza (1998) says that low-cost resolutions for attaining an opening automated audit capability include preliminary CAATS that simplify data mining, arrangement, and investigation processes.

These programs need a little exercise, have no file size restrictions, deliver detailed audit logs for use as work paper certification, and permit the formation of auditor-specified reports that may be applicable to present and future data sets. These tools should be primarily used to substitute manual audit accomplishments because these are parts where the most considerable benefits might ensue. For example, the programs could be arranged to perform tasks such as balancing ledgers, selecting statistical samples, making confirmations, and identifying doubtful transactions. In addition, such mechanisms have the ability to test 100% of the records comprised in a file; this is a noticeable enhancement over the sampling techniques historically create in the old-fashioned manual audit. Using these programs, auditors are capable of getting a well sympathetic of business processes as well as improved levels of capability and professional cynicism. In terms of shortcomings, tools in this type do not function on an accurately ongoing basis. As such, although they certainly offer the functionality to improve audit quality, it may eventually be desirable to consider other methods that more closely align with the future audit (Lanza, 1998).

In addition to the previous software concerns, exercise matters should be addressed throughout the procedure of computerizing the audit function. For example, Curtis and Payne (2008) stated that although CAATS are gifted of humanizing the efficiency and effectiveness of auditing purposes, such tools incline to be underutilized. Consequently, appropriately created and effected training programs may assist more comprehensive implementation and usage of CAATS by practitioners (Janvrin, 2008). Sufficient training will be a vital element of any audit computerization initiative in order to boost the probability that auditing staff will get complete gain of the benefits that automated tools can offer. A purposefully formulated and employed plan that includes cautious consideration about matters of conflict, cost and benefit balances, project scope, and training should product in more favorable outcomes. At a minimum, CAATS have the capability to work as a networking instrument among the manual audit and the eventual future audit. If executed and used as envisioned, substantial advantages will be recognized such that firms should be more exposed to entertain the concept of offering further into the ground of automation.

In the upcoming audit, as before stated basic CAATS comprise competencies to improve audit effectiveness and efficiency. However, they do not function on a 24/7 basis and consequently flop to build a truthfully incessant auditing atmosphere whereby omissions and inconsistencies may be recognized as they happen. Instead stated, they do not operate with real-time or near to real-time data streams and, thus, are not capable of solving doubtful events such as possible fraud or abnormalities in an enhanced fashion. Cangemi (2010) says that assuming the current progress in business technologies, the ongoing stress on the backward looking audit is just an archaic philosophy. Instead, he considers that real-time resolutions are required. As such, firms that effectively trial with the CAATS defined previously should provide ultimate consideration to more innovative programs which hold functionalities approximating the audit of the future and deliver a higher level of assertion. Providentially, lately projected solutions better fulfill this image.

Overall, the programs in this type comprise the abilities to constantly capture omissions and outliers in data arrangements from different systems, deliver information and warning mechanisms to appropriate personnel in a continuing way, and basically challenge matters such as fraud, errors, and a waste of resources in real-time. Besides, these programs may contribute to boosting the audit purpose by investigating all financial transactions as they taken place. As such, this proactive tactic intensifies efficiency and effectiveness in finding out problems and opportunities for business enhancement.

However, proceeding into this more complex domain, further considerations relative to business processes are warranted. In aggregation with this position, Teeter and Vasarhelyi (2011) clarify the best placement of enterprise data and audit procedures. For example, they indicate that manual data relates to manual auditing methods. They also specify that organizational data that is not rigorously manual may be subject to computerized audit procedures on a certain level. Thus, the more manual data an entity preserves, the less it might primarily advantage from audit automation. In order to decide the potential function of a vigorous auditing system, an organization should first contemplate the degree to which its data is automated. Succeeding this, recognized manual enterprise data might rationally be changed to a more automated state preceding to the employment of tools for automating the audit practice.

In traveling towards the future audit, the degree to which data, controls, and processes are automated must be reflected. A company that is overloaded by manual audit practices will need to challenge this matter at some point if the objective is to harvest best benefits from the future audit. Basically, if the organization computerizes its data, controls, and processes in a way that appropriately aligns with the functionalities of the technology being executed, the business will probably be in a situation to boost audit quality.

An enterprise that travels toward better automation relation to data, processes, controls and monitoring tools activates to naturally building itself for the approaching of the future audit. Assuming the current arrival of the real-time economy, this setting is critical. For example, the Continuous Audit Monograph (CICA/AICPA, 1999) denotes that the progress of the digital economy has assisted a demand from decision makers, such as potential investors and creditors, for a more appropriate announcement on a wide arrangement of information topics extending well beyond the old-fashioned financial statements. Thus, if these decision makers need a more incessant information stream on which to make decisions, they will also demand independent assertions about the trustworthiness of that information.

Consequently, the need for a 24/7 auditing procedure becomes outward if firms plan to compete for rare resources and eventually succeed in the recent and progressing real-time global economy. With this in mind, one could say that the old-fashioned manual and reconsidering audit is becoming an unsustainable position. Also, it could be said that the use of basic CAATS such as those defined previously will ultimately be examined in terms of the audit function. Fortunately, the awareness of the future audit is not a current phenomenon and there are a diversity of methodologies that have been planned to reach this upland.

2.1.9. Escalating Demand for Accountancy, Auditing in Ethiopia

The necessity for accountancy and audit in Ethiopia is intensifying. A few years back a College graduate in Ethiopia was expected to Outlook a better chance of getting a job a lot faster than a graduate from any additional discipline. Whether the circumstance is still accurate or the observation is incorrect altogether, one mechanism we can say for certain is that with the booming private businesses the necessity for accountancy services also rising. In the corporate domain elsewhere accountants have a solid hold in the day-to-day operation of the business (Jaffar, 2008).

Beginning from the easy task of holding the daily financial lifespan and sketch up periodic reports of the firm, the accountants in the advanced corporate setting assume the obligation of trustworthy business consultants. Major causes that impact the profit of corporate such as cost saving, risk assessment and so on are inside the dominion of the responsibility of the accountants (Senait, 2003). In other ways, accountants could also accept the role of external auditors who have an authority to assess the financial actions of the business and securitize the effort and the reports of the internal accountants. Therefore the auditors, particularly in the corporate setting that we are discuss, command a better power in affecting decisions. Shareholders and administrative board affiliates are going be contingent on the auditors' report to make their decisions. Thus at some level, there is no doubt that they control and guide the management and, it is assumed, that they undertake this power with the shareholders' interest in mind (Senait, 2003).

Although the Ethiopian business atmosphere has a long way to drive before it encounters the highest standards of the western corporate standards, the newborn private businesses in the economy presently need accountants and auditors to accomplish at least portion of the aforementioned tasks. Now it should be eminent that the accountants' obligation also requires a uniform greater accountability. Business units clearly are there to make a sensible profit and appropriate financial management is a significant factor in achieving that objective (Dessalegn & Aderajew, 2007). Consequently, the need for accountancy facility has been and currently is on the escalating in Ethiopia.

Nevertheless, Dubiso (2010), auditor-general of the Federal Audit Bureau, says unlike side of the story. In his research, which concentrated on the audit profession in Ethiopia, he mentioned the rudimentary problems in the occupation. Dubiso (2010) thought that at the way, the private business arrangement in Ethiopia is growing into a corporate structure. He thought most of the businesses, whether the newly-forming or the previously organized ones are building their efforts to convert into shareholders' ownership. Based on the auditor-general the progress floors the manner for businesses to execute further sophisticated accounting exercises. Besides, preceding the early 1990s the need for accountancy services, mainly for auditing, was nearly non-existent in Ethiopia, he articulated. On uppermost of that, he mentioned out that excluding in a handful of institutions, even currently audit report is not among the requisite to make business communication. He went to express that in the industrialized world financial organizations and many business partners' demand proper periodical audit reports to undertake business. In this regard, he admired the inspiring initiatives made by the Commercial Bank of Ethiopia and the Ethiopian Commodity Exchange. In spite of all of the above points, though, Dubsio (2010) is hopeful about the rising demand for the audit package in the economy.

Conversely, the paper also sheds light on the difficulties related to the escalating audit service suppliers. The bureau accompanied a combined valuation of the audit service in Ethiopia with the World Bank. Based on the auditor-general, the valuation derived out with slightly anticipated inadequacies in the sector. Amongst other things, the excellence and the reliability of the audit reports formed by the audit firms were extremely examined by the evaluation. Though, Dubiso (2010) was not ardent to place all the blameworthiness on the fledgling and less experienced audit firms. "In the aspect of insufficient exercise and unsatisfactory administration, we can't responsible the firms", he states. The bureau, which is accountable to appropriately monitor and issue permits for the audit firms, regarding its date, relatively shares the responsibility for the prevalent inadequacies.

In reaction to the valuation and its opposing outcomes the government, at the moment, is operating on a draft regulation that would rule the general financial and audit reporting in the country, it was erudite. The manuscript, among other things, targets at restructuring the matters in the auditing sector to one liable body. The draft encompasses comprehensive plans to establish an independent group which would be liable to assess professional principles and tools out model standards for the general audit reporting practice. Dubiso (2010) mentions that implementing a monotonous and tolerable reporting system all over the country would be uppermost of the program for the imminent governor of the sector.

Moreover, he thought that it was a serious mission to select the most fortunate audit and financial system in the due reflection of the country's financial certainties. Hereafter, this independent body would adopt exclusive responsibility to accomplish all of the above-mentioned obligations in tallying to the permitting and monitoring of the operators in the auditing segment. On an associated note, it was also erudite that the draft regulation also aims to establish a vigorous academic institute that would exertion on the enhancement of professionals. The plan targets to have an institute like the Association of Certified Chartered Accountants (ACCA) to deliver professional exercise and qualifications locally. The association would effort to confirm professionals according to the native need of the profession and the sector. It is to be thinking of that ACCA offers training and certificates in the ranges of accountancy and financial management far and wide over the world.

2.2. Empirical Literature

As the main aim of this research is to examine the determinants effect for the efficiency of external audit engagement on Ethiopian share companies, various authors and researcher's investigations and recommendations concerning the associated topic of external audit practice in different parts of the world and in Ethiopia are described and presented. Although the introduction of external a recent phenomenon; the efficiency of external audit engagement on share companies are challenged because of the factors that hamper the development of external audit in Ethiopia. For the simplicity of presenting the literature those studies concerning the main determinants/factors/ that affect the efficiency of external audit engagement on share companies; such as internal control system, firm size, auditor's fee, organizational independence, auditor qualifications and proficiency, and auditor's reputation from different researchers are included in these literature.

Internal control is a practice, effected by an entity's board of directors, management, and other personnel, aimed to deliver rational assurance concerning the accomplishment of objectives (INTOSAI: International Organization of Supreme Audit Institutions, 1998). Audit efficiency is achieved by a procedure of identifying and controlling the actions needed to attain the quality objectives of a SAI. Since an entity's internal control is in the purview of its audit committee

(Krishnan, 2005), the link between audit committee efficiency, external audit effectiveness and internal control softness is a matter to be studied. The study finds that the internal control system was the critical determinants of audit committee effectiveness and by then to the external audit efficiency through providing a vital monitoring role to assure the quality of financial reporting and corporate responsibility and that will create a road for external audit efficiency. Likewise, Carcello and Neal (2000) in their research finding reveals that level and nature of review procedures, the approach to audit judgments and issues, independent quality control reviews and its approach to risk, critical assessment of the internal control mechanisms of clients, and audit teams and audit committees performance of responsibilities in line with the agreed standards can contribute to the effectiveness of external audit works. Thus, the effective internal control system of both audit firms and share companies have a vital effect on audit efficiency.

The trouble in measuring audit efficiency has directed many researchers to use audit firm size as a proxy. Large audit firms are presumed to accomplish more dominant assessments. As a result, larger audit firms are more probable to be related with more accurate information than are smaller audit firms, all else being the same (Beatty, 1989; Titman and Trueman, 1986). Investigative research has proposed that audit firm size and audit efficiency are positively related. For example, De Angeio (1981), suggests that larger firms deliver higher-quality audits since larger audit firms have fewer inducements to compromise their standards to ensure the preservation of clients in contrast with smaller firms. Likewise, Dopuch and Simunic (1982), debate that audit efficiency is a function of the amount and degree of audit processes accomplished by the auditor and that larger firms have more capitals with which to perform assessments, Moore and Scott (1989), reveal systematically that audit firm size and the magnitude of audit work are positively related. In their study the size of external audit firms was measured in terms of the probable to be related with more accurate information; inducements to compromise standards to ensure the preservation of clients, and amount and degree of audit processes accomplished by the auditor and capitals with which to perform assessments.

Furthermore, Krishnan and Schauer (2000), studied the relationship between auditor size and audit efficiency for a sample of not-for-profit organizations. Their audit efficiency measure was built on the entity's obedience with GAAP reporting requirements. Audit firms were alienated into three groups: Big Six, large non-Big Six and small non-Big Six. They initiate that obedience improved as one progressed from the small non-Big Six to large non-Big Six and from the large non-Big Six to Big Six. They also verified the auditor size–audit efficiency linkage with a more continuous assessment of audit firm size: the number of professionals working for audit firm and this test further confirmed their outcome. Thus, audit firm size and audit efficiency are positively related according to the prior studies.

An independent audit committee improves the impartiality of external auditor, and make sure that auditor is free from management impact. The committee can perform informal and private summits without the attendance of the company's management to inspire the external auditor to be clear on valuable matters at an early phase. The best-recognized explanation of independence in academic literature is De Angelo (1981), the uncertain likelihood of reporting a discovered breach; others comprise an outlook/state of mind Schuetze (1994); a function of acting with the truthfulness and honesty being vital Magill and Previts (1991).

Geiger and Raghunandan (2002), proposed that auditors with longer tenancy are more probable to be independent, and are steady with Myers et al. (2003) in that elongated auditor tenancy is related to the higher worth of reported earnings. This implies that auditors with higher audit efficiency (i.e., auditors independent) are more probable to fight back client management forces than auditors with lower audit efficiency. The organizational independence were measured in terms of interference and influence of auditing activities; auditors freedom to decide the scope, time and extent of auditing procedures based on auditing standards; auditors access to necessary documents, information and data about the organization/sector for their audit work; auditors freedom to include any audit finding in their audit work and report directly to responsible body; and auditors efficiency to probably fight back client management forces. These studies were observed auditor independence in auditor-client cooperation over financial reporting matters, and whether highly efficient auditors are more likely than least efficient auditors to fight back client management forces in auditor-client cooperation over financial reporting matters. Currently, financial disgraces at firms such as Enron and WorldCom have worn out public confidence in the independence of the accounting profession and the efficiency of audit services.

The focal drive of the audit is to assure outsiders that the financial statements are free from valuable misstatements, the significance of an audit be contingent on the outsiders' ex-ante insight of the likelihood that the auditor will ascertain the ruptures or mistakes in the reporting system and on the likelihood that the auditor will report the revealed ruptures or mistakes (De Angelo, 1981). Many investigate discover that there is a positive relationship between audit efficiency and the auditor qualifications and proficiency. For example, Sundgren (1998) initiate that non-certified auditors are less probable to adapt the audit report, which advocates that non-qualified auditors deliver lower assurance than qualified auditors. Simunic and Stein (1987) proposed that though auditor moral hazard has received raid consideration in the academic literature, it is supposed to be predominantly serious in the government setting. The auditors' qualification and proficiency were measured in terms of sufficient skilled external auditor and certification in auditing; audit team members responsive to clients' requests and their consistency; on time completion of audit procedures and evidence collections; audit team members sufficient industry experience and understanding of clients' business and its issues; and level of strength of audit team to works together effectively. In this atmosphere, the likelihoods of client financial failure and resultant ex-post exposure of lower-than-implied audit efficiency are slight. Thus, there is a need for alternative mechanisms for enhancing the credibility of the audit. Mutually the General Accounting Office GAO (1987) and the American Institute of Certified Public Accountants AICPA (1987) sight proper audit attaining practices as a tool for safeguarding that the contracted audit efficiency is in fact provided.

Audit fees refer all charges that the companies pay to the external auditors against for the audit services and non-audit services, e.g. management consultative and advisory. Auditing fees comprise primarily of the salaries and benefits of office and field workers, transport costs, and other costs necessary to the audit and associated support undertakings. The fees equivalent the projected cost of staff time and the real cost of travel for those undertakings, plus a margin of profit. In their argument of Kinney and Libby (2002), proposed that the danger to auditor independence could be as robust when the audit fee is huge. Numerous investigations that have empirically studied the association between audit efficiency and audit fee; Francis and Simon (1987), thinking that audit services are quality-differentiated and that in a competitive market, quality variances are replicated in charges. However, since audit fees have a number of determining factors, they are a raucous proxy for efficiency.

A preceding study which studies whether, in an Australian situation, the presence of an audit committee, audit committee features and the use of internal audit are related with a greater level of audit fees determines that a higher audit fee indicates higher audit efficiency (Francis, 2004). The study was measured the audit fee in terms of the appropriateness of the audit fee given the scope of the external audit; danger to auditor independence; and discussion made for the level of outstanding fees with the audit committee and payment of such fees before the report is issued. Several writers debated that managers and entrepreneurs are ready to pay higher audit fees to obtain what are seeming to be higher audit efficiency.

An auditor's reputation is positively linked to the perceived and definite levels of efficiency replicated by the auditor's report. Choi and Jeter (1992) revealed a narrowed stock market reaction to earnings reports when a qualified opinion is handed out. If auditor quality is endangered, the audit report delivers a lower level of assertion to the users of financial reports that the financial reports imitate the firm's business actuality and a higher likelihood that its earnings and book values have been inflated lacking being identified by its auditor. Accordingly, they studied Arthur Andersen's clients' stock market influence adjacent dates on which Andersen's audit processes and independence were under severe examination as well as Andersen's clients' auditor shift dates. A high-quality job momentously raises the likelihood that audit outcomes will depend on and suggested enhancements will be extremely considered and applied.

In more recent times the Global Financial Crisis has understood policy makers once again concentrate attention on the significance of an effective audit role as a key element in effective capital markets and try to identify key drivers of audit efficiency. For example, in the US the Advisory Committee on the Auditing Profession (2008) was organized to deliver advice to the US Treasury Department on the auditing occupation. Likewise, in the UK the Financial Reporting Council released The Audit Quality Framework (2008), correspondingly in Australia; The Treasury released Audit Quality in Australia– a Strategic Review (2010). These soundings and regulatory modifications make it pure that there has been substantial frustration with the effectiveness of corporate governance, the efficiency of the audit process and the starring role of auditors and auditing.

In reaction, regulators and the accounting professionals have engaged a number of policy actions to develop audit efficiency in both fact and appearance. Current examples include the SEC's recommended prohibition on audit firms undertaking non-audit services (NAS) in 2000 (SEC 2000) and the quick approval of SOX resulting Enron's breakdown (Francis 2004). For instance, while audits are currently mandatory by law, previous empirical evidence in audit literature advocates that presence of financial statement auditing was prevalent long before legal requirements. Specifically, in the U.S. in 1926 before any audit regulation, independent auditors checked as much as 82% of the companies on the New York Stock Exchange (Benston, 1969; Chow, 1982). This observation evidently shows the fundamental significance of auditing as economical external governance mechanism giving protection for stakeholders or users of financial statements.

Hameed (1995), found that the most significant factors that influence auditing efficiency are auditor's experience, honesty, and the knowledge in accounting and auditing standards. Alqam and Alrajabi (1997), in their study in public Jordanian companies, found that auditor rotation is affected by three groups; firm level factors such as management replacement, auditing office particular factors such auditing quality, and factors linked to international auditing principles and auditing ethics. Wong (2001), found that the usage of computer aided audit procedures instead of old-fashioned data mining gives to the achievement of auditing task. Brown, et al. (2006), found that auditor independence does not, by itself, significantly damage the quality of financial information. Khasharmeh, (2002) found that the auditor must be carefully chosen objectively and not grounded on the inter-relationships among the board of directors and the auditor. Preceding researchers recognized a positive association between audit efficiency and some factors like internal control. Further studies have engaged more straight actions, such as the results of quality control, firm scope, audit fees, auditor independence, auditor standing, industry specialty, auditor experiences, and ability.

In African countries like Nigeria auditing is not yet well developing and current reports of doubtful accounting practices engaged by some businesses in Nigeria have carried the matter of audit efficiency to the forefront, and place the auditing profession in a solemn credibility crunch (Otusanya & Lauwo, 2010). A study results made in Nigeria by Uchenna (2011) display that economic reliance on the client, delivery of non-audit services to the client, and rivalry in the audit market are the main factors that weakens the perception of audit efficiency and that this is regular among both sets of respondents. On the other hand, minor audit fees, the risk of a penalty against the auditor, and minor audit fees as a fraction of the firm's total revenues are supposed to improve audit efficiency. A study result made in Kenya by Guandaru (2014) witnessed that audit committees effectiveness plays a substantial role in improving audit efficiency. Organizations may, therefore, reflect constructing capability of the audit committees so as to develop external audit efficiency. The study in advance found out that there is a statistically significant causative link among the level of external auditor's abilities and audit efficiency in Kenya.

Like other African countries, even though the Ethiopian business setting has a long way to drive before it encounters the high standards of the western corporate environments, the toddler private businesses in the economy still necessitate accountants and auditors to accomplish at least portion of the above-mentioned tasks. Here it should be considered that the accountants' obligation also involves an even greater accountability. Some studies are taken in different parts of the world; Naghashiyan (1393) in his article assessed the effect of internal auditor's performance quality on execution time of external audit, Rezaee (1391) in his article scrutinize the impact of internal audit on external audit practice, Pezeshkzade (1391) in his article investigation the dependence of external auditors on various types of internal audit were evaluated, Samavati (1379) in her research investigation the practice of analytical technique, definition value and usage of financial external audit built on small and medium organizations in Iran were taken. Some other studies also focus on audit quality on Small and medium-sized enterprises (Umar, 2011), audit effectiveness on Ethiopian public sector (Dessalegn, 2007), and the usefulness of accounting comparability for audit engagement (Hongbo, 2012).

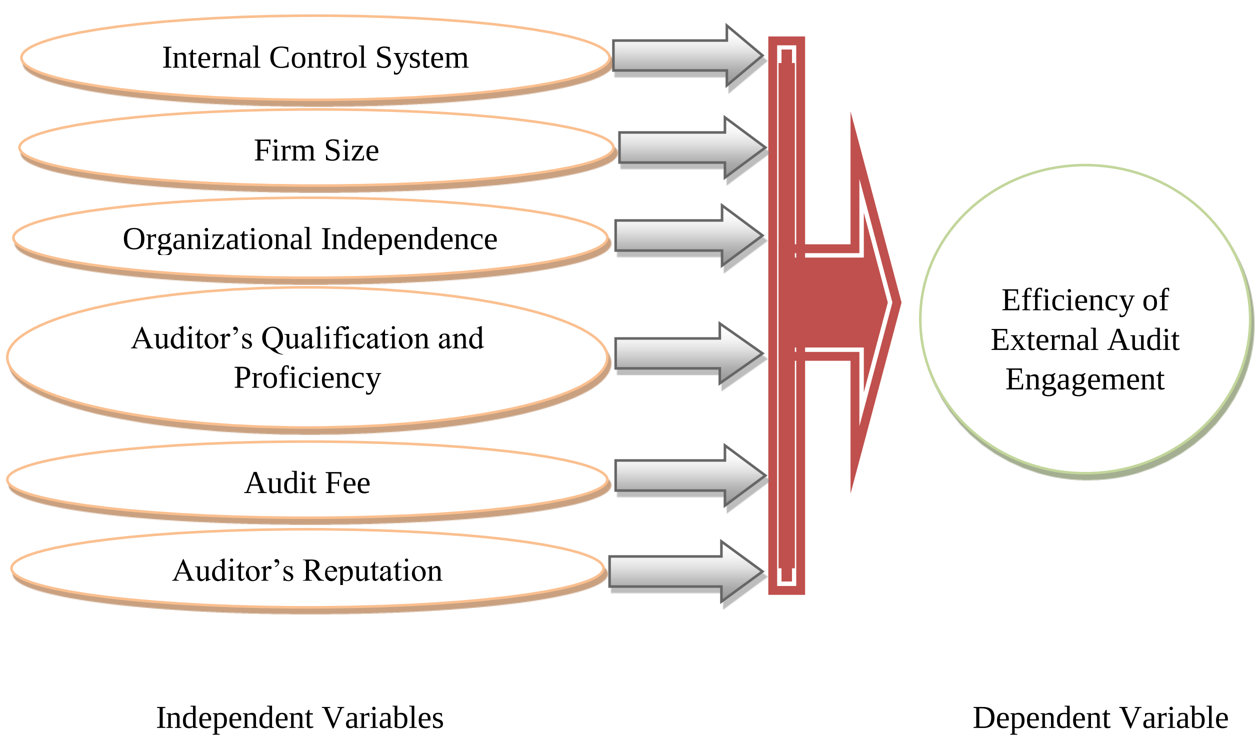
Generally, in the long run existence of an organization, the efficiency and effectiveness of an audit engagement have a significant role for making various sound decisions, especially external auditing. Thus, inefficiency and low-quality employment of it in the sector will create different sorts of problems and will affect the creation of value chain, as it is one determinant factor in the value chain. Some studies was taken place in Ethiopia considering the audit practices example, the effects of long-term auditor-client relationship on audit quality (Aamir and Farooq, 2011), audit efficiency in Ethiopian public sector (Dessalegn, 1997), and the effect of the external auditors' ability to assess fraud risk on their ability to detect the likelihood of fraud (Jaffar, 2008), however, the problems raised with related to the efficient employment of external audit engagement on Ethiopian share companies is remains an open question. With regard to this, the researcher was attempting to examine the determinants effect for the efficiency of external audit engagement on Ethiopian share companies. Specifically, the research was considered the following determinants for the efficiency of external audit engagements using study literatures: the internal control system, firm size, auditor's fee, organizational independence, auditor qualifications and proficiency, and auditor's reputation.

2.3. Conceptual Framework

In the absence of efficiency, the worth of audit services will be greatly reduced (Sweeney, 1992) and in turn, if an auditor lacks efficiency, this upsurges the probability that they would be seeing as fewer objectives and for that reason less probable to report a discovered rupture. Balanced audit practice results in a higher level of audit efficiency being delivered on financial statements (Baber et al., 1995).

In other words, if the auditor is not efficient, the inducement to do a highly efficient audit is weakened, as misstatements will not be reported even if found (pike, 2003). The conceptual framework links the independent's variables which are determinants affecting the efficiency of external audit engagement to the dependent variable which is efficiency of external audit engagement:

Figure 2.1: Conceptual Framework



CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

3.1. Research Design

It is important for one to decide which method are most suited to the particular requirements of each individual study, and in doing so, to consider the purpose and nature of different methods such as qualitative, quantitative and mixed research methods. To decide on the method that will be adopted, it is important to see the philosophy of each method.

The study was attempted to contribute to the knowledge base by examining the efficiency of external audit engagement and its determinants on Ethiopian share companies. To reach this purpose, it was better to use mainly explanatory/causal type of research design and in some cases descriptive type. This was because the descriptive approach is suitable for describing situations or events as what, when, where, how they exist. The explanatory/casual approach, most of the cases, were used whenever the research goes beyond description, and to state relationships as well as causes and effects between variables.

In addition, the study were used both quantitative and qualitative research approaches. Quantitative methods have an objective approach, where data is controlled and measured to, address the accumulation of facts to determine the cause of the behavior. More broadly, as stated by Creswell (1994), a quantitative approach is one in which the investigators primarily uses positive claims for developing knowledge (i.e. cause and effect thinking, reduction to specific variables and hypotheses and questions, use of measurement and observation, and the test of theories), employs strategies of inquiry such as experiments and surveys, and collect data on pre-determined instruments that statistics data (Creswell, 1994). This approach uses quantitative data for analysis as it stated by Firestone (1987), quantitative data are data which can be stored, classified, measured in a strictly objective way they are capable of being accurately described by a set of rules or formula or strict procedures which then make their definition (if not always their interpretation) unambiguous and independent of individual judgments.

Alternatively, qualitative researchers have a more holistic approach and will study documents and case histories and carry out observations and interviews. Their data is collected within the context of its natural occurrence. Beside it view data from another's perspective and in so doing attempt to find understanding and meaning, here concerns center on the changing and dynamic nature of reality. Moreover, as stated by Creswell (1994), a qualitative approach is an approach in which the inquirer regularly makes awareness claims based mainly on constructivist aspects (i.e. the numerous implication of individual familiarity meaning communally and previously created, with an intention to developing a theory or blueprint) or promotion/ participatory perspectives (i.e. political, matter-oriented, mutual, or alteration oriented) or together.

Finally, combining methods (mixed method) ultimately strengthens the value of the research. Quantitative researchers will want consist or stable data to enable them to replicate their findings, whilst qualitative researchers require validity of data to provide a presentation of a true and full picture. According to Creswell (1994), a combined methods approach is one in which the researcher inclines to base knowledge claims on pragmatic surroundings. It engages strategies of inquiry that encompass gathering data either concurrently or consecutively to the finest understanding of research problem. The data gathering also encompass collecting both numeric information (e.g. on interviews) so that the final database represent both quantitative and qualitative information (Creswell, 1994).

The research was aimed at examining the efficiency of external audit engagement and its determinants on Ethiopian share companies. To achieve specified important objectives and test hypothesis, it is good to use mixed method than other methods. This is because quantitative methods are essential for analyzing the relationship between variables systematically and help to test the hypothesis; in addition to this quantitative method also helpful for statistical techniques aided by computational algorithms and software package for analysis. On the other hand, qualitative methods are helpful for studying documents and carry out interviews. These reasons make mixed method better than others to achieve the objective of the paper.

Under the mixed method, the researcher has used information gathered from the survey to assess findings from a drawn sample back to a population because of various reasons. The survey was used because it helps the research to the breadth of coverage of many people and events means that it is more likely than some other approaches to obtain data based on a representative sample, and can, therefore, be assessable to a population. It was also used because it helps the research to produce data based on real world observations (empirical data) and to select a relatively large sample of people from a pre-determined population followed by the collection of a relatively small amount of data from those individuals to make some inference about the wider population. The researcher used information gathered from the survey to generalize findings from a drawn sample back to a population (Baarttlietttt, 2001). Besides, the survey was selected because of the fact that it gives the opportunity to study a variety of factors, especially attitudes, as well as can produce a large amount of data in short time at a fairly low cost.

3.2. Source and Type of Data

The study was mainly used one source of data which is primary source of data. This research work was made usage of primary data mainly through the employment of questionnaires and interviews which were administered to external audit firms. Specifically, the primary data source was collected from senior external auditors and supervisory auditors of the external audit firms. This is because it suits the type of inquiry that was being conducted by the researcher, and the availability of funds and time had also been adequate in order to undertake it.

3.3. Methods of Data Collection

Data for the survey was collected from the target population by means of self- administered questionnaire and interview, respectively. A self-administered questionnaire was considered to be the most appropriate primary survey instrument in this assessment. This is because it addresses the issue of reliability of information by reducing and eliminating differences in a way that the questionnaire was asked and facilitate the collection of data within a short period of time from the majority of respondents (Choudrie, 2005). Also, an interview was used to get information from the survey because it helps to greater rapport established with the respondent allows the more complex issue to be included, it also provides high response rate, and provides better data quality and it was used as a support for questionnaire responses. It was conducted with the one who supervises senior auditors in audit firms and ten supervisors are expected to respond to the interview questions of the study.

The questions used in the questionnaire was closed-ended which were designed as scale measurement base using five-point Likert-type Scaling. The scaling was (1) represent strongly disagree, (2) disagree, (3) neutral, (4) agree, and (5) strongly agree. Thus, the variables can be scaled to measure the degree of their agreement or the disagreement of the respondents which the variables can be elicited. Close-ended questions are included in the questionnaire in order to obtain a high response rate. Further, close-ended questions are quicker and easier both for respondents and researcher. Indeed, in the engagement of the research mainly primary data collection methods were used and this was because the study needs the respondents' opinion or response regarding the issue to be investigated. In order to test the reliability of the data collected using this methods a reliability taste were made and discussed in the results and discussion part of this study.

3.4. Population and Sample of the Study

The population for the study was senior external auditors employed in external audit firms in Ethiopia. Now a day's Ethiopia has a number of external audit firms providing their service for different business sectors in their different parts. There are a total of about 65 private audit firms operate in Ethiopia, registered by the Federal Office of Auditor General and the number of external auditors on the activities of the audit firms is about more than 1274, which indicates both senior and junior auditors, out of that 741 are senior external auditors. In this study, the researcher was used a formula provided by Kothari (2004) to determine the sample size of the survey and the samples only encompass senior external auditors since they have better knowledge regarding the existing audit practices rather than junior auditors. The researcher has included about 81 samples from the finite population.

The following formula were used to determine sample size for the finite population of the study (Kothari, 2004) by taking the average present inefficiency of the auditing practice in Ethiopia on the basis of prior study was 51%, acceptable magnitude or error (E) of 5%, and confidence level (Z) of 95%.

$$\boxed{n = \frac{Z^2 \times p \times q \times N}{E^2(N-1) + Z^2 \times p \times q}}$$

Where *n* = Sample size

p = efficiency population proportion

q = 1-*p*

Z = confidence level

E = acceptable magnitude of error

$$= \frac{(0.95)^2 \times 0.49 \times 0.51 \times 741}{(0.05)^2 \times (741-1) + (0.95)^2 \times 0.49 \times 0.51} = 81$$

For the determined samples, purposive sample selection technique was used in the selection of respondents. As the existence of share companies in clients of external audit firms is a prerequisite for respondent selection, audit firms servicing clients which are share companies were included in the sample. After identifying those audit firms which have share companies as a client, they were given a proportional number of respondents from each. Audit firms which provide these services for share companies during the investigation of this study were about 27 out of 65 audit firms. From each 27 purposively selected audit firms, based on their experience in auditing their clients' share companies, a proportional number of senior auditors were selected to provide a response for the study. That means, as number of senior external auditors in audit firms increases the sample taken from each also increases proportionally for the determined sample. Proportional number of respondents were taken into consideration from the purposively selected audit firms in order to support the generalizability of the study results. It was adopted by considering the population of the study which was senior external auditors in Ethiopian audit firms and required to fill the questionnaire and respond to the interview.

3.5. Description of Study Variables

The study had one dependent variable and six independent variables. Efficiency of External Audit Engagement (AUDITEF) was assumed as a dependent variable to measure the efficiency of external audit engagement in the study and the independent variables was internal control system (INTCSYS) to measure the effect of internal control system of audit firms on external audit efficiency, firm size (FIRMSIZ) to measure the effect of audit firm size on external audit efficiency, organization independence (ORGINDP) to measure the effect of organizational independence on external audit efficiency, auditor's qualification and proficiency (AUDTRQP) to measure the effect of auditor's qualification and proficiency on external audit efficiency, audit fees (AUDITFE) to measure the effect of audit fee on external audit efficiency, and auditor's reputation (ADTRREP) to measure the effect of auditor's reputation on external audit efficiency. The independent variables were measured using a 5-point Likert-type scale and this scale was selected so that the subsequent data is agreeable to statistical analyses in testing the research hypotheses (Bohrnstedt and Knoke, 1994; Hair Jr., et al., 2006).

3.6. Model Specification and Data Analysis Tools

To achieve the objectives of the research and to test the formulated hypothesis, it is important to use an appropriate data analysis technique so as to organized, analyzed, and interpreted the data in a sensible way. The specific objectives of the study were required to look the dependence of one factor over the other and to determine those affecting factors. To achieve this, the study was used multiple linear regression model of econometrics. This is because the linear probability model (LPM) is simple to estimate and use, but it has drawbacks such as the fitted probabilities can be less than zero or greater than one and the partial effect of any explanatory variables (appearing in level form) are constant (Maddala, 1992). These limitations of the LPM can be overcome by using more sophisticated models such as OLS estimators (Wooldridge, 1999).

Multiple linear regression were used in order to determine and interpret the significance and direction of the coefficients of independent variables. In order to analyze the data and use the models, the study was used Stata Software, since the software best fits for this study. Moreover, to overview factors affecting efficient employment of external auditing as well as to determine whether the external auditing principles and procedures are being efficiently applied, the findings of all data collected will be presented using frequency tables, graphs, and pie charts for presenting and describing the results of the responses. Therefore, six hypothesis were analyzed through multiple linear regression model. As a result, in order to examine the effect of independent variables on external auditing efficiency, the following multiple linear regression model is formulated for the study.

Model: Multiple linear regression:

$$\mathbf{AUDITEF} = \boldsymbol{\beta_0} + \boldsymbol{\beta_1}\mathbf{INTCSYS} + \boldsymbol{\beta_2}\mathbf{FIRMSIZ} + \boldsymbol{\beta_3}\mathbf{ORGINDP} + \boldsymbol{\beta_4}\mathbf{AUDTRQP} + \boldsymbol{\beta_5}\mathbf{AUDTFEE} + \boldsymbol{\beta_6}\mathbf{ADTRREP} + \boldsymbol{\varepsilon}$$

Where, AUDITEF denotes efficiency of external audit engagement which was measured using Chartered Professional Accountants (CPA) efficiency measures in Canada related to assessment of external auditing practice in Canada, 2014, such as auditor’s ability to identify noncompliance activities, provision of value for client companies, process control abilities, efficient determination of audit scope and nature, adequacy of firm requirements, fulfilment of auditors requirements, on time and proper payment of audit remunerations, and quality provision of audit service.

INTCSYS is internal control system which was measured in terms of level and nature of review procedures, the approach to audit judgments and issues, independent quality control reviews and its approach to risk, critical assessment of the internal control mechanisms of clients, and audit teams and audit committees performance of responsibilities in line with the agreed standards. FIRMSIZ is the size of the auditing office which was measured in terms of the probable to be related with more accurate information; inducements to compromise standards to ensure the preservation of clients, and amount and degree of audit processes accomplished by the auditor and capitals with which to perform assessments. ORGINDP is organizational independence of audit firms which were measured in terms of interference and influence of auditing activities; auditors freedom to decide the scope, time and extent of auditing procedures based on auditing standards; auditors access to necessary documents, information and data about the organization/sector for their audit work; auditors freedom to include any audit finding in their audit work and report directly to responsible body; and auditors efficiency to probably fight back client management forces. ADTRREP is the reputation of the auditing office which was measured in terms of the quality of auditors' work.

Besides, AUDTFEE is auditing fees which were measured in terms of the appropriateness of the audit fee given the scope of the external audit; danger to auditor independence; and discussion made for the level of outstanding fees with the audit committee and payment of such fees before the report is issued. AUDTRQP is the qualification and proficiency of auditor which were measured in terms of sufficient skilled external auditor and certification in auditing; audit team members responsive to clients' requests and their consistency; on time completion of audit procedures and evidence collections; audit team members sufficient industry experience and understanding of clients' business and its issues; and level of strength of audit team to works together effectively. Besides, ε denotes the random error which was made throughout the study. Since the data collected for the study has a scale nature as well as in order to simplify the data analysis path of the study i.e. to meet normality assumption, the relationship between the dependent and independent variables for the multiple regression parts was expressed in a logarithmic function.

CHAPTER FOUR

4. RESULTS AND DISCUSSION

4.1. Introduction

As demonstrated in the preceding chapter, the key attempt of this study is to examine the efficiency of external audit engagement and its determinants in Ethiopian share companies. Thus, this section presents the analysis and discussions of research results obtained from the questionnaires and interviews. It reports the investigation findings obtained from senior external auditors and supervisory auditors of the external audit firms providing their service to share companies in Ethiopia covered in the questionnaire. The discussion starts with the questionnaires' response rate followed by the descriptive statistics of the respondent's associated queries; such as age, gender, profession, educational level, and year stay in the company. The outcomes of the reliability analysis and the regression assumption test as well reported and lastly, the outcomes of hypothesis testing are presented.

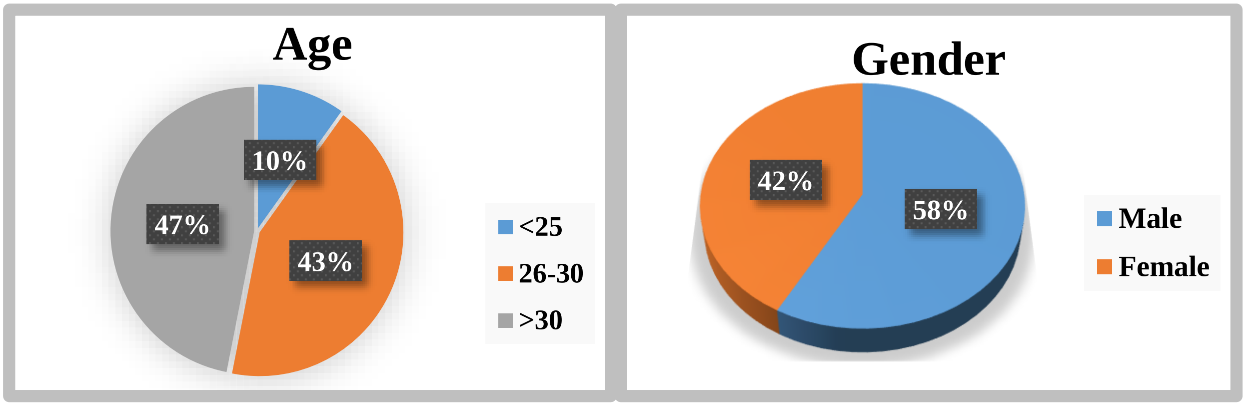
4.2. Descriptive Statistics

4.2.1. Response Rate

The questionnaires were circulated to senior auditors of the selected audit firms which provide their service to share companies and interviews were made with supervisory auditors in those audit firms. For these respondents, 81 questionnaires were distributed to the senior external auditors and from which 81 questionnaires were collected (35 responses each from senior external auditors) giving the response rate of 100% and this indicates good response rate for the senior external auditors. In addition, interviews were made to 7 supervisory auditors (8 responses each from supervisory auditors) giving the response rate 70% and this indicates a satisfactory response rate for the supervisory auditors.

4.2.2. Respondents Profile

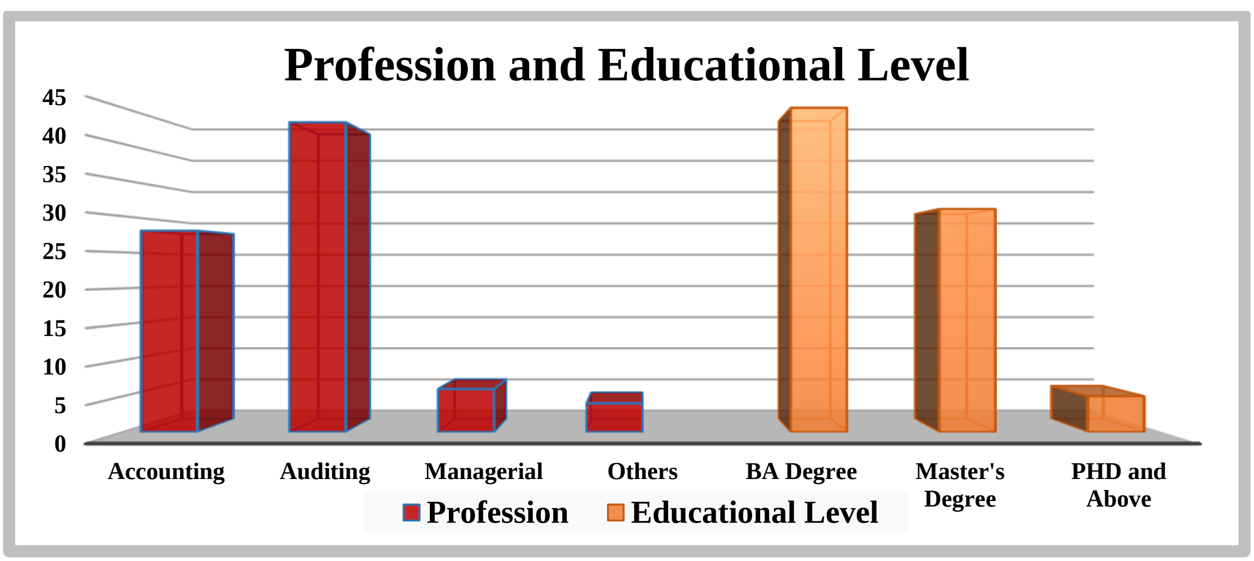
Chart 4.1: Description of respondents with respect to their age and gender



Source: Survey data, 2017 Excel output

As presented in the pie chart 4.1 above, the age composition of the respondents with a percentage of 10% was found less than 25, 43% were between 26 to 30, and 47% were above 30 age. From this, the researcher found out that most of the respondents were above 30 age. Additionally, out of the total of respondents, 58% were males and about 42% were females. This implies that auditors in the external audit firms are more of males and audit related activities are largely performed by them.

Chart 4.2: Respondents with respect to their profession and educational level



Source: Survey data, 2017 Excel output

As displayed in chart 4.2, the professions of respondents were 34 (34.6%) have an accounting profession, 43 (53%) have an auditing profession, 6 (7.4%) have a managerial profession, and 4 (5%) respondents have other professions. This implies that more of the audit engagement activities are accomplished by auditors and this would have a vital contribution to the efficiency of the external audit engagement since auditors are main players for an audit engagement. Furthermore, the educational level of respondents displays that out of the total of respondents 45 (55.5%) of respondents have BA degree, about 31 (38.3%) have Master's Degree, and 5 (6.2%) of the respondents have Ph.D. and above level. This implies that educational level of external auditors in audit firms is more of BA degree and audit engagement activities are largely performed by them. This would have little impact since more of external auditors have only basic auditing skills but they have to know the advanced ones and that will enhance the efficiency of external audit engagements.

Table 4.1: Description of respondents with respect to their stay in the company

Background	Year	Number of Respondents	Percentage (%)
Stay in the company	0-5 Year	56	69%
	6-10 Year	19	23.5%
	>10 Year	6	7.5%
Total		**81**	**100%**

Source: Survey data, 2017 Excel output

Table 1 shows the length of time respondents stay in the audit firms and as a result, about 69% of the respondents are stayed in between 0 to 5 years, 23.5% are between 6 to 10 years, and 7.5% stays in the audit firms for more than 10 years. This indicates that more of external auditors in the audit firms are stay between 0 to 5 years and the work experience of those auditors is not that much enough to become efficient in performance. As a result, the current auditor's experience is little and it has little impact on efficiency of external audit engagment.

As Table 4.2 below shows, out of 81, the respondents being studied 31 (42%) respondents responded that external audit engagement on Ethiopian share companies is efficient. Likewise, the remaining 47 (58%) respondents respond that the external audit engagement on Ethiopian share companies is not efficient. From this, we can understand that more of the respondents were agreed on the inefficiency of external audit engagement on Ethiopian share companies.

Table 4.2: Percentage of efficient and non-efficient external audit engagement by respondents under the study

External Audit Efficiency	Y code	Frequency	Percentage (%)
Yes	1	34	42%
No	0	47	58%
Total		**81**	**100%**

Source: Survey data, 2017 Excel output

According to Dubiso (2010), auditor-general of the Federal Audit Bureau, preceding the early 1990s the need for accountancy services, mainly for auditing, was nearly non-existent in Ethiopia. On uppermost of that, he mentioned out that excluding in a handful of institutions, even currently audit report is not among the requisite to make business communication. He went to express that in the industrialized world financial organizations and many business partners' demand proper periodical audit reports to undertake business. In order to do that we need to have an efficient external audit engagement, however, external auditing practice was a recent phenomenon in Ethiopia and that makes the practice more of inefficient as elaborated in the above table.

4.3. Reliability Analysis

To measure the reliability of the questionnaire mainly Likert-type of scale, the reliability analysis is vital in reflecting the general reliability of constructs that it is determining. To undertake the reliability analysis, Cronbach's Alpha (α) is the most communal measure of scale reliability and a value greater than 0.700 is very acceptable (Field, 2009; Cohen and Sayag, 2010). As displayed in Table 4.3 below, the value for Cronbach's Alpha (α) was 0.7850 for all variables. Compared with the minimum value of alpha 0.700 advocated by Field (2009), Cohen and Sayag, (2010), then the responses made for all of the variables' used in this study were reliable enough for the data analysis.

Table 4.3: Reliability Statistics

Cronbach's Alpha	
Test scale = mean(unstandardized items)	Test scale = mean(standardized items)
Average interitem covariance: .0014824 Number of items in the scale: 7	Average interitem correlation: 0.3928 Number of items in the scale: 7
Scale reliability coefficient: 0.7850	Scale reliability coefficient: 0.8191

Source: Survey data, 2017 Stata output

4.4. Assessment of Ordinary Least Square Assumptions

4.4.1. Assessment of Normality

In order to test the normality of data, Shapiro-Wilk W test of normality and kernel density estimate graph for normality were used and conducted on Stata 12. If the residuals are normally distributed, the Shapiro-Wilk statistic would not be significant and W value would be 1 or approach (Guajarati, 2007.). This means that the p-value given at the bottom of the normality test screen should be greater than 0.05 and W should be 1 or approach to support the null hypothesis of the presence of normal distribution at the 5 percent level. In addition, to be normal the kernel density estimate graph should be bell-shaped.

Table 4.4: Test of normality

Shapiro-Wilk W Test					
Variable	Obs	W	V	Z	Prob>z
r	81	0.98679	0.196	- 0.192	0.57610

Source: Survey data, 2017 Stata output

As shown in Table 4.4 above the Shapiro-Wilk statistics was not significant at 5% level of significance as per the P-values are shown in the table (i.e. 0.57610). Hence, the null hypothesis of the residuals follows a normal distribution is failed to reject at 5 percent of significant level. Therefore, it seems that the error term in all of the cases follows the normal distribution and it implies that the inferences made about the population parameters from the samples tend to be valid. In addition, the kernel density estimate graph for normality was bell-shaped (See Appendix-IV: B)

4.4.2. Assessment of Heteroskedasticity

When the scatter of the errors is dissimilar, varying contingent on the value of one or more of the independent variables, the error terms are heteroskedastic (Guajarati, 2007). The error term is homoscedastic if the variance of the conditional distribution of the error term given independent variables is constant, and in particular, does not depend on the independent variable; otherwise, the error term is heteroskedastic (Stock and Watson, 2003). Heteroskedasticity test is very vital because if the model involves of heteroskedasticity problem, the OLS estimators are no longer BEST and error variances are incorrect, consequently the hypothesis testing, standard error, and confident level will be invalid. There are a lot of statistical tests to test heteroskedasticity in regression errors.

We can use the White’s test for heteroskedasticity and Breusch-Pagan test for heteroskedasticity to test for the possible existence of heteroscedasticity in our model. For the regression output of the model both the two tests were conducted on Stata 12 to test for homogeneity of variance and a p-value of greater than 0.05 was acceptable. As the result revealed in Table 4.5 below, p-value (=0.3248) and (= 0.7508) for the model is greater than 0.05 the critical value, shows homogeneity of variance across the model at 5 percent of significant level.

Table 4.5: Test of Heteroskedasticity

Cameron & Trivedi's decomposition of IM-test based on White’s test				**Breusch-Pagan / Cook-Weisberg Test**
Source	chi^2	Df	p	Ho: Constant variance Variables: fitted value of log_auditef chi2(1) = 0.10
Heteroskedasticity	31.93	27	0.2347	
Skewness	4.62	6	0.5939	
Kurtosis	0.63	1	0.4275	
Total	37.18	34	0.3248	Prob > chi^2 = 0.7508

Source: Survey data, 2017 Stata output

4.4.3. Assessment of Multicollinearity

Multicollinearity occurs when there are strong correlations between the predictors and the existence of value greater than 0.80, tolerance value lower than 0.10 and Variance Inflation Factor (VIF) greater than 10 in the correlation matrix are the causes for multicollinearity occurrence (Guajarati, 2007). Tolerance is a statistics used to show the variability of the specified independent variable that is not explained by the other independent variables in the model. As shown in Table 4.6, the tolerance levels for all variables are greater than 0.10 and the VIF value are less than 10 (see Table 4.5 below), and likewise the correlation matrix of all the variables have the paired values between the predictors are less than 0.80 (see Table 4.6 below) point out that there were no multicollinearity problems that alters the analysis of the findings, rather it forwards to the acceptance of rvalue, tolerance and VIF values.

Table 4.6: Collinearity Statistics

Variable Inflation Factor (VIF)		
Variable	**VIF**	**1/VIF**
Log_AUDTFEE	2.84	0.352390
Log_INTCSYS	2.76	0.361769
Log_ORGINDP	1.59	0.630208
Log_AUDTRQP	1.50	0.666903
Log_ADTRREP	1.28	0.779737
Log_FIRMSIZ	1.16	0.862659
Mean VIF	1.85	

Source: Survey data, 2017 Stata output

Table 4.6 below depicts the correlation between the independent variables and the result shows the acceptable reliability of the research variables in which, the correlation among predictors were not high (less than 0.80) indicates there is no multicollinearity problem among variables. Since, as a rule of thumb, correlation above 0.8 between independent variables indicates the existence of the problem of multicollinearity and VIF above 10 shows the existence of multicollinearity (Guajarati, 2007).

Table 4.7: Correlation matrix of coefficients of regress model

Variables	Log_ICL	Log_FSZ	Log_OIP	Log_ARQ	Log_AFE	Log_ARN
Log_INTCSYS	1.0000					
Log_FIRMSIZ	0.0913	1.0000				
Log_ORGINDP	0.5465	0.1459	1.0000			
Log_AUDTRQP	0.4748	- 0.1333	0.4024	1.0000		
Log_AUDTFEE	0.7686	0.2363	0.5480	0.4084	1.0000	
Log_ADTRREP	0.3708	- 0.0231	0.3094	0.3884	0.3843	1.0000

Source: Survey data, 2017 Stata output

4.4.4. Assessment of Autocorrelation

Data were assessed to make sure that the autocorrelation is not a threat for the use of OLS for analysis. This assumption can be tested with the Durbin-Watson test which test for serial correlation between errors and the value closer to 2 are acceptable (Field, 2009). As Table 4.8 below, the Durbin-Watson d-statistics value is 1.986369 very close to 2 suggests that there is no severe autocorrelation among error terms.

Table 4.8: Test of autocorrelation

Durbin-Watson Test Statistics
time variable: time, 1 to 81 delta: 1 unit
Durbin-Watson d-statistic(7, 81) = 1.986369

Source: Survey data, 2017 Stata output

4.4.5. Assessment of Model Specification (Omitted-Variables)

Testing for omitted variable bias is vital for our model as it is connected to the assumption that the error term and the independent variables in the model are not correlated. If we are omitting one variable in our model and “(1) is correlated with the comprised regressor; and (2) the omitted variable is a determining factor of the dependent variable” (Stock and Watson, 2003), then our regression coefficients are inconsistent. The null hypothesis is that the model does not have an omitted-variables bias, as shown in Table 4.9 below the p-value is 0.6938 higher than the typical threshold of 0.05, so we fail to reject the null and conclude that we do not need more variables.

Table 4.9: Model specification test

Ramsey Test
Ramsey RESET test using powers of the fitted values of log_auditef
Ho: model has no omitted variables
F(3, 71) = 0.48
Prob > F = 0.6938

Source: Survey data, 2017 Stata output

4.5. Econometrics Regression Results and Hypothesis Testing

To achieve the objectives of the research and to test the formulated hypothesis, it is important to use an appropriate data analysis technique so as to organized, analyzed, and interpreted the data in a sensible way. The regression results that are obtained by regressing the efficiency of external audit engagement in identifying noncompliance activities and the external auditors ability in adding value for share companies and their firm on the internal control system (INTCSYS), firm size (FIRMSIZ), organizational independence (ORGINDP), auditors' qualification and proficiency (AUDTRQP), audit fees (AUDITFE), and auditors' reputation (ADTRREP) were analyze and described. The researcher was used Multiple linear regression model in order to analyze the collected data, determine, and interpret the significance and direction of the coefficients of independent variables. Since the data collected for the study has a scale nature as well as in order to simplify the data analysis path of the study i.e. to meet normality assumption, the relationship between the dependent and independent variables for the multiple regression was expressed in logarithmic function. The specific objectives of the study were required to look the dependence of one factor over the other and to determine those affecting factors. To achieve this, the study was used multiple linear regression model of econometrics. Finally, the hypothesis tests were carried out based on the developed hypothesis and the regression output results.

4.5.1. Results of Ordinary Least Square (OLS) Estimation

The regression result examines the effects of the determinants for the efficiency of external audit engagement by using the variables identified in the model. As displayed in the model summary (Table 4.10) the proper determinants of the variable used to examine the efficiency of external audit engagement were examined. That is the value of R square used to examine how much of the variance in the dependent variable (AUDITEF) identify by the model. Usually but not necessarily, the larger the value of R-square indicates the better the model is.

Table 4.10: Ordinary Least Square (OLS) regression result for the efficiency of external audit engagement

Number of Obs. = 81	**R^2 = 0.7451**	**Adjusted R^2 = 0.7244**		
F(6, 74) = 36.05		**Prob > F = 0.0000**		
Independent Variables	**Coefficients**	**Standard Error**	**t**	**p > t**
Internal Control System	.2894608	.1244760	2.33	0.023
Firm Size	.0579413	.0505423	1.15	0.255
Organizational Independence	.4421521	.1003162	4.41	0.000
Auditors' Qualification and Proficiency	.3118322	.0807671	3.86	0.000
Audit Fee	.2120155	.1028196	2.06	0.043
Auditors' Reputation	.0517586	.0566508	0.91	0.364
Constant	-.2258041	.0644875	-3.50	0.001

Source: Survey data, 2017 Stata output

According to Table 4.10 above, the overall contribution of internal control system, firm size, organizational independence, auditors' qualification and proficiency, audit fees, and auditors' reputation for the efficiency of external audit engagement accounted for 74.51% (R^2 = 0.7451) of the variation in the efficiency of external audit engagement, the remaining 25.49% are other variables not included in this investigation.

In addition, the model summary as well shows the significance of the model by the value of F-statistics (P =.000) and F = 36.05 which indicates that there were strong relationship between the predictors and the results of the regression variables and are at best fit the model to predict the efficiency of external audit engagement in Ethiopian share companies. The beta (β) sign also demonstrations the positive (+) or negative (-) effect of the independent variables coefficient over the independent variable. As presented in Table 4.10 above, a beta sign of all the independent variables demonstrations the positive effect of the predicting dependent variable which is external audit efficiency. It reveals that any increase in the independent variables leads to increase in the dependent variable which is efficiency of external audit engagement. This outcome is consistent with most of the previous empirical literature that are identified in this study (Beatty, 1989; Titman and Trueman, 1986; Geiger and Raghunandan, 2002; Simunic and Stein, 1987; Kinney and Libby, 2002; Choi and Jeter, 1992).

Consequently, based on the coefficients of the independent variables (β sign) all the hypotheses developed by the researcher are acceptable since of all the sex hypotheses identified the positive relationship with the dependent variable which is efficiency of external audit engagement are meet. However, based on the statistical significances of the independent variables on the dependent variable at 5% level of significance, only four independent variables (Internal Control System (INTCSYS), Organizational Independence (ORGINDP), Auditors' Qualification and Proficiency (AUDTRQP), and Audit Fee (AUDTFEE)) have significantly significant contribution for the efficiency of external audit engagement (AUDITEF) at ($P<0.05$) level of confidence. The variable with the level of significance ($p>t$) value less than 5% could have a significance unique influence to the predicted value of the dependent variable, beyond this level of significance the variable could not have a significance influence for the prediction of the dependent variable (Pallant, 2007; Somekh and Lewinn, 2005). Thus, those variables have a statistically significant p-value (which means that their coefficients are statistically different from 0) which implies they have an important impact on the efficiency of external audit engagement, holding other variables constant for each variable.

Therefore, it indicates that internal control system, organizational independence, auditors' qualification and proficiency, and audit fee are the most significant determinants for the efficiency of external audit engagement in which the audit firms should give more emphasis in their external audit function while making an audit engagement on Ethiopian share companies.

Moreover, as observed from the above table 4.10, even if the result obtained in the estimation is insignificant, there is a positive relationship between firm size (FIRMSIZ) and efficiency of external audit engagement, and similarly between auditors' reputation (ADTRREP) and efficiency of external audit engagement. As a result, they have no significant contribution for the predicted dependent variable which is efficiency of external audit engagement (AUDITEF) since they have a significance value of greater than 5%.

4.5.2. Test of Hypotheses

The regression analysis whose outcomes are presented in Table 4.10 above delivers a more comprehensive and accurate investigation of the research hypothesis. As a result, the regression results attained from the model were used to test these hypotheses. The hypotheses sought to test for a significant influence of internal control system (INTCSYS), firm size (FIRMSIZ) organizational independence (ORGINDP), auditors' qualification and proficiency (AUDTRQP), audit fee (AUDTFEE), and auditors' reputation (ADTRREP) on the efficiency of external audit engagement.

The efficiency of external audit engagement was measured in terms of external auditor's ability to identify noncompliance activities, provision of value for client companies, process control abilities, efficient determination of audit scope and nature, adequacy of firm requirements, fulfilment of auditors requirements, on time and proper payment of audit remunerations, and quality provision of audit service.

As can be understood in Table 4.10 above the p-value for internal control system (INTCSYS), organizational independence (ORGINDP), auditors' qualification and proficiency (AUDTRQP), and audit fee (AUDTFEE) are statistically significant at ($p< 0.05$) which proposes a strong support for hypothesis H1, H3, H4 and H5, respectively; whereas, firm size (FIRMSIZ) and auditors' reputation (ADTRREP) do not support the developed hypothesis H2 and H6, respectively, because they were statistically insignificant at ($p <0.05$). The following hypotheses test were made based on the regression outcomes of the external audit efficiency obtained from the regression output.

H1: Effective internal control system has a positive and significant effect on efficiency of external audit engagement

The first hypothesis of this research posed that the efficiency of external audit engagement is directly related to the extent of the internal control system strength. Table 4.10 indicating the strongly correlated relationship between the efficiency of external audit engagement and the internal control system, the positive beta sign and a statistically significant result of the internal control system associated with efficiency of external audit engagement ($\beta = .2894608$, $t = 2.33$, and $p<0.05$) support the proposed hypothesis acceptable.

The internal control system in terms of level and nature of review procedures; the approach to audit judgments and issues; independent quality control reviews and its approach to risk; critical assessment of the internal control mechanisms of clients (share companies); and audit teams and audit committees performance of responsibilities in line with the agreed standards can contributes to the efficiency of external audit engagement in share companies.

The result of the study was consistent with the previous auditing research works. Since an entity's internal control is in the purview of its audit committee (Krishnan, 2005), the link between audit committee efficiency, external audit effectiveness and internal control softness is a matter to be studied. The study finds that the internal control system was the critical determinants of audit committee effectiveness and by then to external audit effectiveness through providing a vital monitoring role to assure the quality of financial reporting and corporate responsibility and that will create a road for external audit efficiency. Similarly, Carcello and Neal (2000) in their research finding reveals that level and nature of review procedures, the approach to audit judgments and issues, independent quality control reviews and its approach to risk, critical assessment of the internal control mechanisms of clients, and audit teams and audit committees performance of responsibilities in line with the agreed standards can contribute to the effectiveness of external audit works.

Therefore, internal control system can contribute to the efficiency of external audit engagement in terms of level and nature of review procedures, the approach to audit judgments and issues, independent quality control reviews and its approach to risk, critical assessment of the internal control mechanisms of clients, and audit teams and audit committees performance of responsibilities in line with the agreed standards; and this in turn strongly supports the first proposed hypothesis (H1).

H2: Size of external audit firms has a positive and significant effect on the external audit efficiency.

The second hypothesis of this research revealed that there was a direct relationship between the size of external audit firms and the efficiency of external audit engagement in the way of identifying noncompliance activities. This hypothesis was not supported by the regression outcome, since the regression results shows that statistically insignificant contribution related to efficiency of external audit engagement at ($p<0.05$). As revealed in Table 4.10 above the coefficient of firm size ($\beta = .0579413$) were positively related but statistically ($t= 1.15$ and $p>0.05$) not significantly related to the efficiency of external audit engagement by identifying noncompliance activities in share companies.

The size of external audit firms were measured in terms of the probable to be related with more accurate information; inducements to compromise standards to ensure preservation of clients; and amount and degree of audit processes accomplished by the auditor and capitals with which to perform assessments as the contributes to the efficiency of external audit engagement in share companies.

Thus, the size of external audit firm's results in statistically insignificant contribution for the efficiency of external audit engagement by identifying the noncompliance activities of share companies in Ethiopia. Even if this variable has a coefficient which is positively associated with the efficiency of external audit engagement, due to its insignificance, regression result leads not to support the second proposed hypothesis (H2).

However, this hypothesis needs an attention; in that statistical insignificance of the size of external audit firms in determining the efficiency of external audit engagement did not mean that it does not absolutely contribute to the efficiency external audit engagement. This result may be occurred due to the organizational independence and the existence of auditors' qualification and proficiency highly contributed to the efficiency of external audit engagement on share companies. This makes the contribution of the size of external audit firms to the efficiency of external audit engagement is insignificance.

The results of the regression are consistent with some of the previous studies only by the direction of the relationship. Larger audit firms are more probable to be related with more accurate information than are smaller audit firms, all else being the same (Beatty, 1989; Titman and Trueman, 1986). Likewise, Dopuch and Simunic (1982), debate that audit efficiency is a function of the amount and degree of audit processes accomplished by the auditor and that larger firms have more capitals with which to perform assessments, Moore and Scott (1989), reveal systematically that audit firm size and the magnitude of audit work are positively related. However, the regression results of this study show an insignificant contribution of the variable.

H3: Organizational independence has a positive and significant effect on efficiency of external audit engagement

The third hypothesis of this research which was supposed to be the determinants for the efficiency of external audit engagement is the organizational independence in which external audit engagement was conducted. As shown in Table 4.10 above the regression outputs supports this hypothesis with a high statistically significant correlation with the level of significance ($p<0.01$) and the positively related coefficient ($\beta = .4421521$, $t= 4.41$, and $p<0.05$) contributes to the external audit efficiency. This indicates the significant impacts of organizational independence through increase the efficiency of external audit engagement to identify the noncompliance activities of share companies.

The organizational independence in terms of interference and influence of auditing activities; auditors freedom to decide the scope, time and extent of auditing procedures based on auditing standards; auditors access to necessary documents, information and data about the organization/sector for their audit work; auditors freedom to include any audit finding in their audit work and report directly to responsible body; and auditors efficiency to probably fight back client management forces can contribute to the efficiency of external audit engagement in share companies.

Furthermore, the outcome of this hypothesis was consistent with the finding of prior audit researchers. Geiger and Raghunandan (2002), proposed that auditors with longer tenancy are more probable to be independent, and are steady with Myers et al. (2003) in that elongated auditor tenancy is related to the higher worth of reported earnings. This implies that auditors with higher audit efficiency (i.e., auditors independent) are more probable to fight back client management forces than auditors with lower audit efficiency. These studies were observed auditor independence in auditor-client cooperation over financial reporting matters, and whether highly efficient auditors are more likely than least efficient auditors to fight back client management forces in auditor-client cooperation over financial reporting matters. Cohen, & Sayag (2010), they find that the more organizational independence to the external auditors plays the vital role in assurance of efficiency of external audit engagement by freely access of necessary documents, information and data about the organization for audit work, and can provide audit finding /report/ freely and directly to the responsible body, and this all supports the efficiency of external audit engagement on share companies.

As a result, the presence of organizational independence between the external audit firms and the share companies contributes to the efficiency of external audit engagement by facilitating the activities of external auditors and to make their purpose and authority in line with the standards for the professional practices. An independent audit committee improves the impartiality of external auditor, and make sure that auditor is free from management impact. Thus, this strongly supports the proposed hypothesis of the significant and positively relationship between the organizational independence and efficiency of external audit engagement (H3).

H4: External auditors' qualification and proficiency has a positive and significant effect on efficiency of external audit engagement.

The fourth hypothesis of this research reveals that the presence of qualified and proficient external audit staff in external audit firms was also supposed to be the determinants for the efficiency of external audit engagement. As displayed in Table 4.10 above, the regression result highly supports this hypothesis at ($P<0.01$) level of significant and with a positively related beta coefficient (β = .3118322, t= 3.86, and $p<0.05$).

The auditors' qualification and proficiency in terms of sufficient skilled external auditor and certification in auditing; audit team members responsive to clients' requests and their consistency; on time completion of audit procedures and evidence collections; audit team members sufficient industry experience and understanding of clients' business and its issues; and level of strength of audit team to works together effectively can contributes to the efficiency of external audit engagement in share companies.

The outcome of the study was consistent with the prior auditing research findings. Sundgren (1998) initiate that non-certified auditors are less probable to adapt the audit report, which advocates that non-qualified auditors deliver lower assurance than qualified auditors. Simunic and Stein (1987) proposed that though auditor moral hazard has received raid consideration in the academic literature, it is supposed to be predominantly serious in the government setting. In their study the auditors' qualification and proficiency were measured in terms of sufficient skilled external auditor and certification in auditing; audit team members responsive to clients' requests and their consistency; on time completion of audit procedures and evidence collections; audit team members sufficient industry experience and understanding of clients' business and its issues; and level of strength of audit team to works together effectively. Furthermore, mutually the General Accounting Office GAO (1987) and the American Institute of Certified Public Accountants AICPA (1987) sight proper audit attaining practices as a tool for safeguarding that the contracted audit efficiency is in fact provided.

Therefore, auditors' qualification and proficiency can contribute to the efficiency of external audit engagement in terms of sufficient skilled external auditor and certification in auditing; audit team members responsive to clients' requests and their consistency; on time completion of audit procedures and evidence collections; audit team members sufficient industry experience and understanding of clients' business and its issues; and level of strength of audit team to works together effectively; and this in turn strongly supports the fourth proposed hypothesis (H4).

H5: Audit Fee has a positive and significant effect on efficiency of external audit engagement.

The fifth hypothesis of this research posed that the efficiency of external audit engagement is affected by the charges that the companies pay to the external auditors against for the audit services. Table 4.10 above demonstrating a highly correlated relationship between the external audit efficiency and the audit fee, the positive beta sign and a statistically significant result of audit fee associated with efficiency of external audit engagement ($\beta = .2120155$, $t = 2.06$, and $p<0.05$) support the proposed hypothesis acceptable.

The audit fee in terms of the appropriateness of the audit fee given the scope of the external audit; danger to auditor independence; and discussion made for the level of outstanding fees with the audit committee and payment of such fees before the report is issued can contributes to the efficiency of external audit engagement on share companies.

The outcome of the study was consistent with the previous auditing research works. Several writers debated that managers and entrepreneurs are ready to pay higher audit fees to obtain what are seeming to be higher audit efficiency. In their argument of Kinney and Libby (2002), proposed that the danger to auditor independence could be as robust when the audit fee is huge. Numerous investigations that have empirically studied the association between audit efficiency and audit fee; Francis and Simon (1987), thinking that audit services are quality-differentiated and that in a competitive market, quality variances are replicated in charges. However, since audit fees have a number of determining factors, they are a raucous proxy for efficiency. A preceding study which studies whether, in an Australian situation, the presence of an audit committee, audit committee features and the use of external audit are related with a greater level of audit fees determines that a higher audit fee indicates higher audit efficiency (Francis, 2004). The study was measured the audit fee in terms of the appropriateness of the audit fee given the scope of the external audit; danger to auditor independence; and discussion made for the level of outstanding fees with the audit committee and payment of such fees before the report is issued.

Therefore, audit fee can contribute to the efficiency of external audit engagement in terms of the appropriateness of the audit fee given the scope of the external audit; danger to auditor independence; and discussion made for the level of outstanding fees with the audit committee and payment of such fees before the report is issued; and this in turn strongly supports the fifth proposed hypothesis (H5).

H6: External auditor's reputation has a positive and significant effect on efficiency of external audit engagement.

The sixth hypothesis of this research revealed that there was a direct relationship between the external auditor's reputation and the efficiency of external audit engagement in the way of identifying noncompliance activities. This hypothesis was not supported by the regression outcome, since the regression, outcomes demonstrates that statistically insignificant contribution related to the external audit efficiency at ($p<0.05$). As presented in Table 4.10 above the coefficient of external auditor's reputation (β = .0517586) were positively related but statistically (t= 0.91and p>0.05) not significantly related to the efficiency of external audit engagement by identifying noncompliance activities in share companies.

The external auditor’s reputation were measured in terms of audit job and the likelihood that audit outcomes will depend on it; the auditor's reputation contribution to the perceived and definite levels of efficiency replicated by the auditor's report; and the level of assertion to the users of financial reports that the financial reports imitate the firm's business actuality as the contributes to the efficiency of external audit engagement on share companies.

As a result, external auditor’s reputation results in statistically insignificant contribution for the efficiency of external audit engagement by identifying the noncompliance activities of share companies in Ethiopia. Even if this variable has a coefficient which is positively associated with the external audit efficiency, due to its insignificance, regression result leads not to support the six proposed hypothesis (H6).

However, this hypothesis requires a consideration; in that statistical insignificance of the external auditor’s reputation in determining the external audit, efficiency did not mean that it does not totally contribute to the efficiency of the external audit engagement. This result may be occurred due to the existence of qualified and proficient external audit staff in external audit firms in line with the proper internal control system and organizational independence as well as appropriate audit fee are strong enough to make efficient external audit engagement function on share companies. As a result, this, in turn, leads to making the result of auditor’s reputation for the efficiency of external audit engagement insignificant contribution and not to support the proposed hypothesis (H6).

The results of the regression are consistent with some of the previous studies only by the direction of the relationship. Choi and Jeter (1992) revealed a narrowed stock market reaction to earnings reports when a qualified opinion is handed out. If auditor quality is endangered, the audit report delivers a lower level of assertion to the users of financial reports that the financial reports imitate the firm's business actuality and a higher likelihood that its earnings and book values have been inflated lacking being identified by its auditor. Accordingly, they studied Arthur Andersen's clients' stock market influence adjacent dates on which Andersen's audit processes and independence were under severe examination as well as Andersen's clients' auditor shift dates. The external auditor's reputation were measured in terms of audit job and the likelihood that audit outcomes will depend on it; the auditor's reputation contribution to the perceived and definite levels of efficiency replicated by the auditor's report; and the level of assertion to the users of financial reports that the financial reports imitate the firm's business actuality. A high-quality job momentously raises the likelihood that audit outcomes will depend on and suggested enhancements will be extremely considered and applied. However, the regression results of this study show an insignificant contribution of the variable.

Generally, the results indicates that audit firms with strong internal control system, greater organizational independence, high and appropriate auditors' qualification and proficiency, and proper audit fee are more likely to have efficiency of external audit engagement and audit firms should give more emphasis in their external audit function while making an audit engagement on Ethiopian share companies. Moreover, as observed from the above table 4.10, even if the result obtained in the estimation is insignificant, there is a positive relationship between firm size (FIRMSIZ) and efficiency of external audit engagement, and similarly between auditors' reputation (ADTRREP) and efficiency of external audit engagement. As a result, they have no significant contribution for the predicted dependent variable which is efficiency of external audit engagement (AUDITEF) on share companies since they have a significance value of greater than 5%.

CHAPTER FIVE

5. SUMMARY OF MAJOR FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

The last chapter of this research aims to summarize major findings, to conclude the finding of the study concentrating on the core determinants that have significant influences to the efficiency of external audit engagement, and to forward recommendations grounded on the research findings of the study as well as to provide future research directions. Conclusions and recommendations are derived from the findings of the study particularly related to the internal control system, the size of external audit firms, organizational independence, auditors' qualification and proficiency, audit fee, and external auditors' reputation.

5.1. Summary of Major Finding

According to the OLS regression outputs all these predictors were positively contributed for the efficacy of external audit engagement on Ethiopian share companies. Therefore, audit firms should give emphasis to use these determinant variables to make their service delivery efficient, effective and economical throughout their clients particularly share companies. Moreover, the internal control system, organizational independence, auditors' qualification and proficiency, and audit fee were the major determinants of efficiency of external audit engagement on Ethiopian share companies. However, in the two regressions the size of external audit firms and external auditors' reputation were not significantly important for the efficiency of external audit engagement on share companies as of the above four variables.

This study finds in the OLS regression that the composite measure of internal control system, firm size, organizational independence, auditors' qualification and proficiency, audit fees, and auditors' reputation accounts for 74.51% (R^2 = 0.7451) variance for the efficacy of external audit engagement in identifying noncompliance activities and added contributions to Ethiopian share companies. That means, the impact of these six independent variables contributed for the dependent variable efficacy of external audit engagement were 74.51%, and the remaining 25.49% were other variables that are not included in this study.

5.2. Conclusions

In the long run existence of businesses, the efficacy of external audit engagement has a significant role in various sound decisions made by external users using financial statements prepared by those businesses. In a decision-making process, decision makers rely upon information, financial statements, as prepared and presented by the management of an entity. In connection to this, the most common way for users to obtain reliable information (reducing the information risk) is to have an independent audit performed. To enhance the degree of confidence of the intended users of the financial statements, a financial statement audit will be conducted by external auditors. Thus, decision makers use the audited information on the assumption that it is reasonably complete, accurate, and unbiased. Thus, the existences of efficient external audit engagement on Ethiopian share companies reduce information asymmetry during decision making and ensures the reliability of financial reports and its process. By taking this context into consideration, this study was examined the efficiency of external audit engagement and its determinants on share companies and then analyzed the organizational dimensions in which the audit firm should carry out to enhance the efficacy of external audit engagement.

According to the OLS regression outputs, all these predictors were positively contributed for the efficacy of external audit engagement on Ethiopian share companies. Therefore, audit firms should give emphasis to use these determinant variables to make their service delivery efficient, effective and economical throughout their clients particularly share companies. Moreover, the internal control system, organizational independence, auditors' qualification and proficiency, and audit fee were the major determinants for the efficacy of external audit engagement on Ethiopian share companies. However, in the regression outputs the size of external audit firms and external auditors' reputation were not significantly important for the efficiency of external audit engagement on share companies as of the above four variables. Besides, by testing of the proposed hypotheses indicated relationships of these independent variables with the efficacy of external audit engagement the following conclusions were derived.

- The efficiency of external audit engagement on share companies is increasing, when there were a strong internal control system, greater organizational independence, high and appropriate auditors' qualification and proficiency, and proper audit fee. The regression analysis (shown in Table 4.10) demonstrates very strong contributions of these variables to the efficiency of external audit engagement. Therefore, the overall effect of the internal control system, organizational independence, auditors' qualification and proficiency, and audit fee in external audit firms is very important for the efficiency of external audit engagement on share companies without neglecting the other two statistically insignificance variables (firm size and auditors' reputation), because they have a positive sign of beta and contribute for the 74.51% of the variances for the efficiency of external audit engagement on the OLS regression. Thus, ignoring these two variables may lead to declining the value for the efficiency of external audit engagement variance that was obtained from the collective contribution of the six independent variables.

- In addition, the regression results also depict all the independent variables have a positive sign of coefficients (shown on table 4.10) with the efficiency of external audit engagement on share companies. However, the size of external audit firms and external auditors' reputation were statistically not significant enough at 5% significance level to contribute to the efficiency of external audit engagement on share companies, therefore this conclusion needs future research should think through for finding the impact of these variables on the efficiency of external audit engagement. The statistics revealed the data to be normal and reliable. Also, the assumptions needed to be fulfilled for OLS regression were tested: the data was found to be homoscedastic, free of autocorrelation, free of multi-collinearity, and normally distributed for the OLS regression.

5.3. Recommendations

In order to make Ethiopian external auditing firms more efficient in their activities, so that they can continue to play their appropriate roles in the growth and development of share companies and the economy at large, measures need to be recommended for their practice. After looking the research findings and attained outcomes with regard to the main objective of this study to examine the efficiency of external audit engagement and its determinants on Ethiopian share companies and also to test the hypotheses, the researcher provides the following recommendations:

- The finding of this research evidenced that the existence of strong internal control system, greater organizational independence, high and appropriate auditors' qualification and proficiency, and proper audit fee were statistically significant and positively related to the efficiency of external audit engagement on share companies. Thus, the external audit firms should provide a vital monitoring role to assure the quality of financial reporting and that will create a road for the efficiency of external audit engagement, should recruited more adequate and competent external audit staff and give sufficient training and professional certification for the existing external audit staffs, should maintain their organizational independence from their clients particularly share companies, and the auditor should be remunerated on the basis of work experience, qualification, duration of the audit assignment, and background profile because the payment of the adequate fee will encourage the auditor to do the assurance engagement assignment according to the high degree of standardization expected.

- The external auditors of the audit firms should recommended to maintain and improve their efficient and effective contribution to the efficiency of external audit engagment in their clients particularly share companies, by using the their strong internal control system appropriately, by improving their professional certification in line with the external auditing standards and by introducing themselves with modern technologies that improve their external audit function for their clients specifically share companies. External audit firms also recommended to increasing the number of certified external auditors by funding the certification fees and also by facilitating the way for certification.
- As the research demonstrated that the existence of strong internal control system, greater organizational independence, high and appropriate auditors' qualification and proficiency, and proper audit fee were the major determinants of efficient external audit engagement on share companies, share companies were recommended to select external audit firms which constitutes those major determinants for the efficiency of external audit engagement through getting support from their audit committees; and also share companies are recommended to support the external audit engagements by providing essential documents and information since it facilitates the work of external auditors.

5.4. Future Research Direction

Obviously, the study is subject to limitations and possible limitations inherent in the sampling technique involved should be acknowledged. That is, purposive sample selection technique was used in the selection of respondents. As the existence of share companies in clients of external audit firms and experience of external auditors in auditing share companies are a prerequisite for respondent selection, senior auditors in those audit firms servicing clients which are share companies were included in the sample. This may limit the generalizability of the conclusions to a population. However, this will have a slight impact on the validity of the results as the study is mainly an analytical survey targeting to identify relations between variables rather than describe the population statistically (Oppenheim, 1992). It should also be stressed that the models developed here and relationship construction of the variables considered the specificities of the Ethiopian share companies, not being applicable in another setting without essential adaptations. Accordingly, the researcher suggests further research test the validity of the models and research hypotheses in other settings.

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Appendixes

Appendix-I: Questionnaire

Jimma University

College of Business and Economics

Department of Accounting and Finance

A Survey on Efficiency of External Audit Engagement and Its Determinants in Ethiopian Share Companies

Questionnaire To Be Filled By Senior Auditors In External Audit Firms Of Ethiopia

Dear Respondents,

This study is conducted in partial fulfillment of the requirements for accounting and finance degree in Masters of Science at Jimma University. The researcher is Fekadu Agmas Wassie. The main objective of this questionnaire-based survey research is to assess and analyze the efficiency of external audit engagement and its determinants in order to contribute to the knowledge regarding auditing role on Ethiopian Share Companies. The questionnaire seeks basic factual information and you can circle the option that you choose or write your answer on the blank space provided.

Your responses to this survey research will be strictly confidential and data from this study work will be coded as well as reported only in the aggregate.

If you have any questions you may contact Fekadu Agmas Wassie by the following address:
Email: *fekaduagmas2005@gmail.com*, Tele: +251 932 87 3022.
Data Collector: Dinku Lema, Tele: +251 943 82 9008.
Melaku Getnet, Tele: +251 941 26 6845.

<table>
<tr><th>No.</th><th>Questions</th><th colspan="5">Your Answers</th></tr>
<tr><td>A</td><td>Background questions</td><td colspan="5"></td></tr>
<tr><td>1</td><td>Age (write in year)</td><td colspan="5"></td></tr>
<tr><td>2</td><td>Gender</td><td colspan="5">1 Male
2 Female</td></tr>
<tr><td>3</td><td>Professions that you have</td><td colspan="5">1 Accounting
2 Auditing
3 Managerial
4 Others</td></tr>
<tr><td>4</td><td>Educational level</td><td colspan="5">1 BA Degree
2 Master’s Degree
3 Ph.D. and above</td></tr>
<tr><td>5</td><td>Your stay in the company (year)</td><td colspan="5">1 0-5
2 6-10
3 >10</td></tr>
<tr><td></td><td colspan="6">From the given choices select the one that represents your idea and circle it to show your answer;
(1) Strongly Disagree (2) Disagree (3) Neutral (4) Agree (5) Strongly Agree</td></tr>
<tr><td>B</td><td colspan="6">Examinations on the relationship between effective internal control and external audit efficiency</td></tr>
<tr><td>1</td><td>Your audit firm has strong internal quality control processes considering the level and nature of review procedures, the approach to audit judgments and issues, independent quality control reviews and its approach to risk.</td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td></tr>
<tr><td>2</td><td>Your audit firm critically looks the internal control mechanisms of its clients whenever it makes audit engagements.</td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td></tr>
<tr><td>3</td><td>The audit team complete their work in line with the agreed standards and audit committee members perform their responsibilities effectively</td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td></tr>
<tr><td>4</td><td>The strength or weakness of your client’s internal control system has little or no impact on the auditor’s opinion.</td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td></tr>
<tr><td>5</td><td>Your audit firm clients, share companies, has high-quality and efficient audit committees so that there is less probability of having internal control weaknesses in those companies.</td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td></tr>
<tr><td>C</td><td colspan="6">Examinations on the relationship between firm size and external audit efficiency</td></tr>
<tr><td>1</td><td>Larger audit firms are not more probable to be related with more accurate information than are smaller audit firms</td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td></tr>
<tr><td>2</td><td>Larger audit firms have fewer inducements to compromise their standards to ensure the preservation of clients in contrast with smaller firms.</td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td></tr>
</table>

3	Audit efficiency is a function of the amount and degree of audit processes accomplished by the auditor and that larger firms have more capitals with which to perform assessments	1	2	3	4	5
D	**Examinations on the relationship between organizational independence and external audit efficacy**					
1	In your firm, auditors perform the auditing activities without any interference from anybody and without any influence from the firm or clients.	1	2	3	4	5
2	In your firm, auditors freely decide the scope, time and extent of auditing procedures based on auditing standards.	1	2	3	4	5
3	In your firm, auditors can freely access necessary documents, information and data about the organization/sector for their audit work.	1	2	3	4	5
4	In your firm, auditors feel free to include any audit finding in their audit work and report directly to responsible body.	1	2	3	4	5
5	Auditors with higher audit efficiency are not more probable to fight back client management forces than auditors with lower audit efficiency	1	2	3	4	5
E	**Examinations on relationships between auditor's qualification and proficiency and external audit efficiency**					
1	Your firm has sufficient skilled external auditors and most of them have certification in auditing.	1	2	3	4	5
2	Audit team members are responsive to clients' requests and consistent in their approach to matters	1	2	3	4	5
3	In your firm, audit procedures and evidence collections are completed on time, since enough and skilled external auditors are available or employed.	1	2	3	4	5
4	In your firm, audit team members have sufficient industry experience for their roles and understand clients' business and its issues	1	2	3	4	5
5	In your firm, there is a strong audit team that works together effectively and that enhancing the credibility of the audit	1	2	3	4	5
F	**Examination on the relationship between audit fee and external audit efficiency**					
1	In your firm, the external audit fee is appropriate given the scope of the external audit	1	2	3	4	5
2	The danger to auditor independence could be as healthy when the audit fee is huge.	1	2	3	4	5
3	In your firm, discussion will made for the level of outstanding fees with the audit committee and payment of such fees should be required before the report is issued	1	2	3	4	5

G	Examination on the relationship between auditor’s reputation and external audit efficiency					
1	A high-quality audit job momentously rises the likelihood that audit outcomes will be depend on it	1	2	3	4	5
2	In your firm, an auditor's reputation has contribution to the perceived and definite levels of efficiency replicated by the auditor's report	1	2	3	4	5
3	If auditor efficiency is endangered, the audit report delivers a lower level of assertion to the users of financial reports that the financial reports imitate the firm's business actuality	1	2	3	4	5
H	**Examination on overall efficiency level of external audit engagement in Ethiopian share companies**					
1	In your firm there is proper and effective internal quality control mechanisms	1	2	3	4	5
2	In your firm size is sufficient enough for making an audit engagements for share companies involved in various business environments	1	2	3	4	5
3	Your firm is organizationally independent from its clients such as share companies and auditors perform their activity freely	1	2	3	4	5
4	In your firm auditors are qualified and proficient for making their purpose particularly in share companies	1	2	3	4	5
5	Your firm performs proper and fair audit fee for an audit engagement made on share companies	1	2	3	4	5
6	Your firm have a greater reputation regarding provision of audit service for share companies	1	2	3	4	5
7	Can we say that there is an efficient external audit engagement in Ethiopian share companies; considering your service provision for share companies which are clients of your audit firm?	**Yes**		**No**		
		1		0		

Appendix-II: Interview Questions

Jimma University

College of Business and Economics

Department of Accounting and Finance

A Study on Efficiency of External Audit Engagement and Its Determinants in Ethiopian Share Companies

Interview To Be Respond By Supervisory Auditors In External Audit Firms Of Ethiopia

Dear Interviewee,

This study is conducted in partial fulfillment of the requirements for the degree in Accounting and Finance in Masters of Science at Jimma University. The researcher is Fekadu Agmas Wassie. The main objective of this interview based research is to assess and analyze the efficiency of external audit engagement and its determinants in order to contribute to the knowledge regarding auditing role on Ethiopian Share Companies. The interview seeks basic factual information and you are kindly asked to give a genuine response.

Your responses to this study will be strictly confidential and data from this study work will be coded as well as reported only in the aggregate.

If you have any questions you may contact Fekadu Agmas Wassie by the following address:

Email: *fekaduagmas2005@gmail.com*. Tele: +251 932 87 3022.

Data Collector: Dinku Lema, Tele: +251 943 82 9008.

Melaku Getnet, Tele: +251 941 26 6845.

Interview Questions:

1. Could you tell us about your firm, and the approximate number of client firms particularly share companies audited annually?
2. Do you provide non-audit services to the client firms as well?
3. Could you tell us what role can the auditor size and brand-name play in maintaining the audit efficiency?
4. Could you tell us how can an audit affect the information credibility and information quality of the client’s financial information?
5. What is your opinion regarding an audit engagement to be efficient?
6. What do you think about the effect of audit fee on audit efficiency?
7. What qualifications and skills should have an Auditor to make audit engagements for clients particularly for share companies?
8. Overall, what do you think about the efficiency of your firm's audit engagements for its clients particularly for share companies?

Appendix-III: Reliability Statistics for Variables

Reliability Statistics: Cronbach's Alpha

```
Test scale = mean(unstandardized items)

Average interitem covariance:     .0014824
Number of items in the scale:            7
Scale reliability coefficient:      0.7850
```

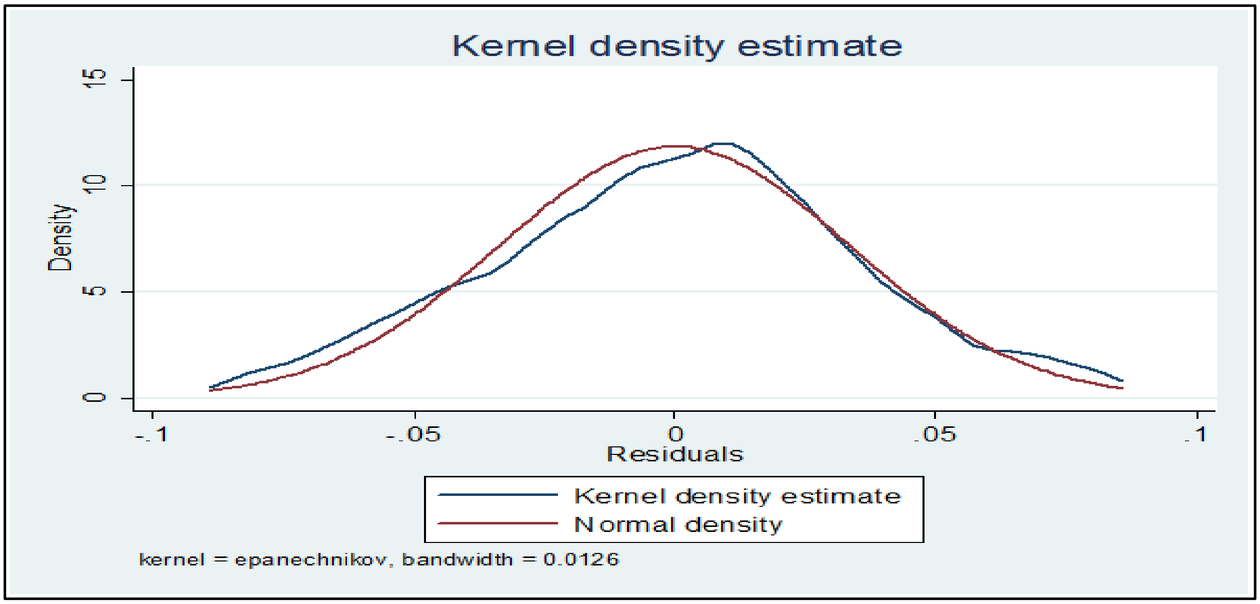
```
Test scale = mean(standardized items)

Average interitem correlation:      0.3928
Number of items in the scale:            7
Scale reliability coefficient:      0.8191
```

Appendix-IV: Assessment of Ordinary Least Square Assumptions

A. Assessment of Normality

Shapiro-Wilk W test for normal data

Variable	Obs	W	V	z	Prob>z
r	81	0.98679	0.916	-0.192	0.57610



B. Assessment of Heteroskedasticity

Cameron & Trivedi's decomposition of IM-test

Source	chi2	df	p
Heteroskedasticity	31.93	27	0.2347
Skewness	4.62	6	0.5939
Kurtosis	0.63	1	0.4275
Total	37.18	34	0.3248

```
Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
         Ho: Constant variance
         Variables: fitted_value_of_log_auditef

         chi2(1)      =     0.10
         Prob > chi2  =   0.7508
```

C. Assessment of Multicollinearity

Variable	VIF	1/VIF
log_audtfee	2.84	0.352390
log_intcsys	2.76	0.361769
log_orgindp	1.59	0.630208
log_audtrqp	1.50	0.666903
log_adtrrep	1.28	0.779737
log_firmsiz	1.16	0.862659
Mean VIF	1.85	

	log_in~s	log_fi~z	log_or~p	log_au~p	log_au~e	log_ad~p
log_intcsys	1.0000					
log_firmsiz	0.0913	1.0000				
log_orgindp	0.5465	0.1459	1.0000			
log_audtrqp	0.4748	-0.1333	0.4024	1.0000		
log_audtfee	0.7686	0.2363	0.5480	0.4084	1.0000	
log_adtrrep	0.3708	-0.0231	0.3094	0.3884	0.3843	1.0000

D. Assessment of Autocorrelation

```
Durbin-Watson d-statistic(   7,     81)  =   1.986369
```

E. Model Specification Test

```
Ramsey RESET test using powers of the fitted values of log_auditef
       Ho:  model has no omitted variables
                  F(3, 71) =      0.48
                  Prob > F =      0.6938
```

Appendix-VI: Results of Ordinary Least Square (OLS) Estimation

Source	SS	df	MS
Model	.264781492	6	.044130249
Residual	.090591435	74	.001224209
Total	.355372927	80	.004442162

Number of obs	=	81
F(6, 74)	=	36.05
Prob > F	=	0.0000
R-squared	=	0.7451
Adj R-squared	=	0.7244
Root MSE	=	.03499

log_auditef	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
log_intcsys	.2894608	.124476	2.33	0.023	.041437	.5374846
log_firmsiz	.0579413	.0505423	1.15	0.255	-.0427664	.158649
log_orgindp	.4421521	.1003162	4.41	0.000	.2422677	.6420365
log_audtrqp	.3118322	.0807671	3.86	0.000	.1509003	.4727641
log_audtfee	.2120155	.1028196	2.06	0.043	.007143	.416888
log_adtrrep	.0517586	.0566508	0.91	0.364	-.0611206	.1646378
_cons	-.2258041	.0644875	-3.50	0.001	-.3542982	-.09731