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**HYPOTHESIS (ES)**

**RESEARCH METHODOLOGY**

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**PRIVATE AUDIT FIRMS IN ETHIOPIA: CHALLENGES AND OPPORTUNITIES****MUHAMMED ARAGIE****LECTURER****DEPARTMENT OF ACCOUNTING AND FINANCE****JIMMA UNIVERSITY****ETHIOPIA****GEBEREAMLAK YITBAREK****LECTURER****DEPARTMENT OF ACCOUNTING AND FINANCE****JIMMA UNIVERSITY****ETHIOPIA****ABSTRACT**

*Any enterprise worldwide relies on two very important and integral components; accounting and auditing. The objective of this study was to investigate challenges and opportunities in the area of regulatory procedures, audit market and human resource for private audit firms' in providing accounting and audit service in Ethiopia. The study employed a mixture of qualitative and quantitative approaches. The results reveal that unavailability of legislations with a brief description of responsibilities, appointment formalities and duties of external auditors, lack of well defined, properly implemented, and updated criteria to scrutinize accountants and auditors, issuance, renewal, suspension and cancellation of certificates of competence are some of the challenges in the area of regulatory procedures. In addition, in the sphere of external audit market low perceived value of the audit function, low demand for professional advice on a variety of business and taxation matters, lack of strong cooperation among private audit firms, unfair competition among audit firms are challenges. Also unavailability of sufficient quantities and qualified audit personnel, higher degree of audit personnel mobility in to another sector (like in banks, insurance, etc) or abroad and low audit fee pertaining to human resource in the country. Thus, a strong financial reporting environment in the country requires active involvement of all stakeholders in continuous reorganization and improvement of legal framework, institutions, accounting and auditing professions, as well as change in its business culture and education system.*

**KEYWORDS**

audit firms, challenges, ethiopia, opportunities, private.

**INTRODUCTION**

Accounting information is the primary vehicle for managers to make assertions about the past performance, current conditions, and future prospects of their firms (Wallin, 1992, pp. 121-47). Auditing is as important as the generation of such information because in the absence of auditing, firm-specific information would be inaccurate. This would result, on one hand, in mismanagement of a firm's scarce resources. On the other hand, inaccurate information would mislead investors in their investment decisions, resulting in inefficient allocation of resources in the economy (Baiman, etal, 1998). However, the importance of accounting of which external audit is a subset is inextricably linked to economic, political, social, and cultural realities of nations (Toms 2005). Uddin and Hopper (2001) and Wickramasinghe and Hopper (2005) provide some evidence of how country specific dynamics influence accounting. As society is a broad concept in which economy, politics, religion, and social relations are embedded (Polanyi 2001), accountings, and thus external audit practice, tend to be influenced by the contextual dynamics that prevail in a society. Against this background, the purpose of this study was to examine a number of factors which can be the challenges and opportunities for the world of external auditing business, to provide valuable and relevant services to various stakeholders, in Ethiopia as perceived by audit practitioners.

**REVIEW OF LITERATURE**

This study is based on selected private audit firms in Ethiopia, an East African country. The existing Government of Ethiopia is a federated state comprised of nine autonomous regional states. The federated state has a bicameral parliamentary structure. The House of People's Representatives is the highest decision-making authority in Ethiopia with members of parliament representing the people. A Federal Council represents the interests of the States. The prime minister is the Head of Government and the president is the Chief of state (Mihret, 2009). The Nation is a member of the Common Market for Eastern and Southern Africa (Nations Encyclopedia 2004) and is in line for World Trade Organization accession since February 2003 (World Trade Organization, 2007). The Country was a developing market-oriented economy since 1974.

The development of accounting principles and reporting practices in different countries is influenced by numerous factors including the culture of the country, the nature and source of financing, the size and structure and complexity of businesses, the capital markets, the tax laws, and the regulatory environment. These differences in operating environments of countries lead to differences in audit objectives, standards, and practices (Richard, e.tal, 2005). Brennan and Kelly (2007) argue that the adequacy of legal protection influences external auditors' likelihood to whistle-blow. In a similar vein, a country's legal protection could influence the role of auditors. A country's environment also serves as an overall setting where professionals who serve as external auditors are produced. The legal basis for external audit emanates from the Commercial Code of Ethiopia (1960) and that for internal audit in state-owned companies emanates from directives issued by the Office of the Auditor General of Ethiopia (Argaw, 1997), whereas it is largely voluntary in the private sector. There is no local GAAP in Ethiopia, except that the Commercial Code of Ethiopia serves as a legal foundation for accounting and external audits of business organizations operating in the country. Supporting these Frank (1979) states that the country did not formally adopt another country's standards nor did it establish national standards. Nonetheless, organizations in some sectors (e.g. commercial banks) are required by government regulation to report in accordance with International Financial Reporting Standards (IFRS). In Ethiopia, due to the absence of an organized strong national professional association there is no comprehensive set of ethical standards to govern the behaviors of professional accountants and auditors. Practitioners are affiliated to Western professional accountancy associations dominantly the Association of Chartered Certified Accountants (ACCA), UK (Mihret, et al., 2009; World Bank, 2007).

There are two external audit sub-markets in the corporate governance setting of Ethiopia. The first is external audit of public enterprises. They are fully government-owned and are governed by board of directors according to proclamation No. 25/1992. Audit Service Corporation, which was established by proclamation No.126/1977, undertakes external audit of this sector. The second sub-market comprises private audit firms. Private audit firms are responsible for the audit of private sector organizations and obtain clients through competitive bidding, which led to a fierce competition in Ethiopia's private sector audit-sub market (Lemessa, 1996, Dessalegn et al., 2011).

For a professional service firms' in particular for private audit firms human capital is the "most important resource" (Hitt et al. 2001, p. 15). Yet, these resources are mobile to an extent not found in settings where capital assets are extensively used. Retention is thus a prime challenge. Loss of senior professionals is especially



costly, not only because it depletes the ability to deliver customized services, but because it severs relationships with clients and is often followed by client defections (Levinthal and Fichman 1988, Baker et al. 1998). Audit firms are thus critically dependent on their ability to recruit, retain, and motivate professionals who are highly mobile.

### NEED OF THE STUDY

The study attempts to explore the factors influence positively or negatively private audit firms. Therefore, identifying country level factors that influence private audit firms from the viewpoint of Ethiopian external audit practitioner's arguably shed light on the improvement areas in development of private audit firms in the country. It also offers important conclusions that can serve as a strong foundation for government policy makers, regulators, practitioners and accounting academics about the current major factors that enhance or inhibit external audit practice in the country, so as to design strategies to upgrade their strength of auditing service and reporting policies.

### STATEMENT OF THE PROBLEM

Companies are perceived as the nexus of contractual relationships between different interested groups (Jensen and Meckling, 1976). The most important among these agency relationships are between managers (agents) and shareholders (principals) and creditors (principals) and shareholders (agents). In these relationships, the agents are expected to act in the best interests of the principals. However, experience shows that various mechanisms must be put in place to ensure that agents protect the interests of the other parties involved. One such mechanism is the audited financial statement (Chow, 1982; Watts and Zimmerman, 1986; Arnold and Lange, 2004). Wallman (1995) stressed that private audit firms are the sole providers of independent audit services, or annual audits and without them to ensure the validity and credibility of financial information, the markets for capital would be far less efficient, the cost of capital would be far higher, and our standard of living would be lower. Performing this crucial role depends largely, among other things, on the availability of conducive environment. In this context, in order to nurture independent audit services in developing countries, particularly in Ethiopia studies aiming for a deeper understanding of key contextual influences on operation of private audit firms' are necessary.

### OBJECTIVES OF THE STUDY

The main intention of this study could be seen as the examination of the possible treats and opportunities in the area of private audit firms' function in the country from the perspective of audit practitioners through gathering primary (using questionnaires and interviews) and secondary research data. More specifically;

1. To identify the current challenges and opportunities to private audit firms in the area of regulatory procedure of the country.
2. To identify the current challenges and opportunities for private audit firms in the area of accounting and audit market of the country.
3. To identify the current challenges and opportunities for private audit firms in the area of the accounting and audit human resource of the country.

### BASIC RESEARCH QUESTIONS

1. What are the factors related to accounting and auditing regulatory procedures considered as challenges and opportunities for private audit firms in the country?
2. What are the factors related to accounting and audit market considered as challenges and opportunities for private audit firms in the country?
3. What are the factors related to human resources considered as challenges and opportunities for private audit firms in the country?

### RESEARCH METHODOLOGY

In order to achieve the research objectives, a mixed research methods is adopted to triangulating research methods. Thus, the study addresses the research problem by collecting and handling a combination of quantitative and qualitative data.

Accordingly, questionnaire surveys of external audit practitioners are conducted. The study covers only private audit firms found in the capital city of Ethiopia, Addis Ababa. The results are then enriched by results of interviews with directors of sample private audit firms' and office of federal auditors general and leaders of accounting and auditing professional associations as well as reviews of relevant documentary evidence.

In the cases of sampling technique, the study adopted probability sampling, specifically simple random sampling, in which each audit practitioners in a private audit firms has equal probability of being selected as a sampling unit.

### DATA PRESENTATION AND ANALYSIS

#### QUESTIONNAIRE ADMINISTRATION

104 numbers of questionnaires were distributed to the participating audit practitioners in each audit firm. 90 were returned but 16 were eliminated from the study because they were either incomplete or inconsistent, leaving 74 useable questionnaires, a 71 percent response rate.

### ANALYSIS OF RESPONSES RELATED TO REGULATORY PROCEDURES

The results in Table 1 show that 37.8 percent of the respondents disagreed and 21.6 percent strongly disagreed about the presence of relevant and detailed regulations and professional standards in Ethiopia to which audit firms and all their staff must adhere, and which support auditor independence. However, 17.6 percent have a neutral opinion, while 13.5 percent agreed and 9.5 percent strongly agreed with this statement.

When respondents were asked regarding availability of legislations with a brief description of responsibilities, appointment formalities and duties of audit firms in general and external auditors in particular in the country, 82.4 percent disagreed and 17.6 percents are neutral to this statement (Table 1).

TABLE 1: NATURE OF REGULATORY PROCEDURES TOWARDS EXTERNAL AUDIT PRACTICE

Items	Response Category	Frequency	Percent
1. Are there relevant, well defined and detailed legal framework, codes of practice and standards in Ethiopia to which audit firms and all their staff must adhere, and which support auditor's independence?	Strongly Agree	7	9.5
	Agree	10	13.5
	Neutral	13	17.6
	Disagree	28	37.8
	Strongly Disagree	16	21.6
	Total	74	100.0
2. Is there a brief description of responsibilities, appointment formalities and duties of audit firms in general and external auditors in particular in the available legislations in Ethiopia?	Strongly Agree	-	-
	Agree	-	-
	Neutral	61	82.4
	Disagree	13	17.6
	Strongly Agree	-	-
	Total	74	100.0

Source: Survey outcomes, 2014

Office of the Federal Auditor General (OFAG) provides licenses to applicants who meet the practicing requirements. A certificate or license defining professional status implies that the holder has a certain minimum level of professional competence (Cooley, 1932, p. 335). For example, according to the Lithuanian Law on

Audit, an auditor is a person who passed auditing exams, has auditor’s certificate and is a member of Lithuanian Certified Accountant (Lithuanian Parliament, 1999). High and demanding requirements for qualification determine several features which are the key elements to be a successful auditor. Similarly, unlike the practice of several other countries where one individual may be licensed to practice both the accountant and the auditor professions, the new legal framework in Albania demands the professionals to choose between being licensed either as auditors or as accountants. The rationale behind this requirement is to provide a clear separation between the accounting and auditing functions by striving to eliminate the risk of overlapping the process of preparing the annual financial statements (performed by the accountants) and the process of auditing these financial statements (carried out by the auditors).

**TABLE 2: REGULATORY PROCEDURES TOWARDS THE ISSUANCE, RENEWAL, SUSPENSION AND CANCELLATION OF CERTIFICATES OF COMPETENCE**

Items	Response Category	Frequency	Percent
1. Do you believe that criteria to scrutinize the applications of accountants and auditors, the issuance, renewal, suspension and cancellation of certificates of competence are well defined in the regulatory procedures, properly implemented, and updated?	Strongly Agree	3	4.1
	Agree	4	5.4
	Neutral	13	17.6
	Disagree	45	60.8
	Strongly Disagree	9	12.2
	Total	74	100.0
2. Do you believe becoming an authorized auditor and accountant is a challenging process because of the regulatory procedures of the country?	Strongly Agree	8	10.8
	Agree	42	56.8
	Neutral	13	17.6
	Disagree	11	14.9
	Strongly Disagree	-	-
	Total	74	100.0

Source: Survey outcomes, 2014

About our country, table 2 shows that 4.1 percent, 5.4 percent and 17.6 percent of the respondents respectively strongly agreed, agreed and neutral that criteria to scrutinize the applications of accountants and auditors, the issuance, renewal, suspension and cancellation of certificates of competence are well defined in the regulatory procedures, properly implemented, and updated. Most of the respondents, 60.8 percent disagree with the above statement, and 12.2 percent strongly disagree with it. Also, for the question asked, most of the respondents (56.8 percent agree and 10.8 percent strongly agree) are of the opinion that becoming an authorized auditor and accountant is a challenging process as a result of the regulatory procedures of the country.

Because of lack of a strong professional body and specifically dedicated institutions, Office of Federal Auditors General (OFAG) regulates the accounting profession. The activities of OFAG in regulating the profession include licensing of all auditors in the country, issuing a Code of Ethics for Professional Accountants, and taking disciplinary measures on proven acts of misconduct by professional accountants and auditors.

Accordingly, for the question respondents asked whether the current regulatory body OFAG able to fulfill properly responsibility of well-organized professional accountancy associations in the country. Thus, 64.9 percent and 25.7 percent of the respondents disagreed and strongly disagreed that OFAG not able to fulfill properly expected responsibilities of national professional accountancy association (Table 2).

In light of this, World Bank (2007), OFAG, institutionally, is facing effectiveness challenges partly caused by the broad nature of its statutory obligations. A World Bank-conducted needs assessment of OFAG in April 2007 noted that in addition to the very broad nature of OFAG statutory powers and duties, it is short staffed and has insufficient human, institutional, and logistical capacity to meet its statutory obligations. Current funding arrangements pose constraints on OFAG for its effective operations, staff operations, and capacity building.

**TABLE 3: OFFICE OF FEDERAL AUDITORS GENERAL AND EXTERNAL AUDIT**

Item	Response Category	Frequency	Percent
1. Do you believe that the current regulatory body (Office of Federal Auditors General (OFAG) able to fulfill properly responsibility of well-organized professional accountancy associations in the country?	Strongly Agree	-	-
	Agree	-	-
	Neutral	7	9.5
	Disagree	19	25.7
	Strongly Disagree	48	64.9
	Total	74	100.0

Source: Survey outcome, 2014

Although the state plays a role in the development of accounting professions, it may be efforts of the professional groups and associations that matter the most (Sian 2006; Uche, 2002). A sustained development of the accountancy profession is best achieved by the creation of a well organized and respected professional accountancy body. They will have key objectives to protect the public interest in all matters that pertain to the profession, establish professional standards, especially standards of professional conduct, promote the education, training and certification of accountants (including continuing professional development and practical experience), developing good relationships with government, other national professional accountancy bodies and regional groupings and represent professional accountants and accounting staff.

**TABLE 4: ROLE OF PROFESSIONAL ASSOCIATIONS TOWARDS EXTERNAL AUDIT PRACTICE**

Item	Response Category	Frequency	Percent
1. Do you believe that the absence of well-organized strong national professional association result some challenges to works of professional auditors and accountants?	Strongly Agree	12	16.2
	Agree	34	45.9
	Neutral	7	9.5
	Disagree	14	18.9
	Strongly Disagree	7	9.5
	Total	74	100.0

Source: Survey outcomes, 2014

Table 4 shows the responses to the question whether absence of well organized strong national professional association result some challenges to works of professional auditors and accountants. Thus, 16.2 percent (strongly agree) and 45.9 percent (agree) believe that absence of well-organized strong national professional association result some challenges to works of professional auditors and accountants. While 9.5 percent, 18.9 percent and 9.5 percent of respondents remain neutral, disagree, and strongly disagree regarding the issue.

As per the researchers opinion this result is similar to findings of Johnson (1996). He stated that most of the countries in Anglophone Africa have an accounting body. The next step is for these bodies to improve the level and quality of their services. While some bodies are fortunate to have financial assistance from their governments, they realize that this is a short-term solution. In the long-term, bodies need to finance their own activities. It is also a problem in Ethiopian context, such as financial constraints, absence of exclusive member benefits tended to constrain member commitment, etc.

The study conducted by Mihret, et al (2012) under their study titled “Accounting professionalization amidst alternating state ideology in Ethiopia” indicate that no indigenous professional accountancy association was empowered by legislation to set standards or to monitor and regulate the accounting profession. Their

findings confirmed that there were some factors that restricted the development of the Association and thus of accountancy in Ethiopia. The first is that the profession is not properly regulated. Although OFAG provides practicing licenses, there is no authorized professional accounting body to monitor the practice. To generalize, the current authoritative body which is empowered to regulate the practice of the profession of accountancy in Ethiopia is OFAG. That is existed accountancy professional bodies in the country have less involvement in sphere of accounting and auditing advancement. To identify the current regulatory activities in the country towards the advancement of accountancy profession, the researcher also raise the following questions to participants of the survey. According to the Table 5 below, 64.9 percent of the respondents disagree and 25.7 percent strongly disagree about the existence of systems with which those private audit firms who have registered outstanding audit service get rewards and the other way round in the country. However, the beliefs of some 9.5 percent of the respondents (agree) differ from the above reality. In the same way, most of the respondents indicated that there is no a mechanism of making/holding liable those private audit firms breach laws, rules and regulations that govern the audit industry, 63.5 percent disagree and 9.5 percent strongly disagree (Table 5).

**TABLE 5: REGULATORY PROCEDURES AND AUDIT FIRMS' PERFORMANCE**

Item	Response Category	Frequency	Percent
1. Do you believe that there is a system in which those private audit firms who have registered outstanding audit service get rewards and the other way round in the country?	Strongly Agree	-	-
	Agree	7	9.5
	Neutral	-	-
	Disagree	48	64.9
	Strongly Disagree	19	25.7
	Total	74	100.0
2. Do you believe that there is a mechanism of making/holding liable those private audit firms breach laws, rules and regulations, which govern the audit industry?	Strongly Agree	-	-
	Agree	14	18.9
	Neutral	6	8.1
	Disagree	47	63.5
	Strongly Disagree	7	9.5
	Total	74	100.0

Source: Survey outcomes, 2014

In overall, the results of this section show that there is a gap between the respondents' expectations and the present statutory requirements for auditors in providing auditing services. This may suggest that the current auditing regulatory framework and role of auditing professional association are deficient and insufficient.

**ANALYSIS OF RESPONSES RELATED TO AUDIT MARKET**

Table 6 presents when 44.6 percent and 36.5 percent of respondents were agreed and strongly agreed respectively about whether auditing function is viewed as a non-value adding activity and a waste of money and resources in the country, 13.5 percents neutral and 5.4 percent disagree. This result supports one of the challenges facing audit practitioners in Malaysia, which is the low perceived value of the audit function. The company auditing in the country was viewed as a waste of money and resources (Lee and Ali, 2008a). Similar to Yapa's (1999) observation in the Bruneian context, there is a prevalence of small and medium enterprises in Ethiopia (a majority of private companies are owner-managed). Hence, an audit appears to be meaningless to most of the private companies because the directors and the shareholders are basically the same people. For this very reason, it explains why most audit clients have found an audit function as a non-value adding activity and perceives it to be a costly process. Regarding the primary reasons why audit clients in the country requesting external audit service, 52.7 percent agree that invitation for an external audit service made only to satisfying the statutory and regulatory requirements. In addition, 64.9 percent of respondents showed that public at large not relies on professional accountants and auditors' competent advice on a variety of business and taxation matters (Table 6).

**TABLE 6: PUBLIC PERCEPTION ABOUT AUDIT FUNCTION**

Items	Response Category	Frequency	Percent
1. Do you believe that an auditing function is viewed as a non-value adding activity and a waste of money and resources in the country?	Strongly Agree	27	36.5
	Agree	33	44.6
	Neutral	7	9.5
	Disagree	7	9.5
	Strongly Disagree	-	-
	Total	74	100.0
2. Do you believe that the invitation for an external audit service made in the country only to satisfying the statutory and regulatory requirements?	Strongly Agree	19	25.7
	Agree	39	52.7
	Neutral	6	8.1
	Disagree	9	12.2
	Strongly Disagree	1	1.4
	Total	74	100.0
3. Do you agree that the public at large rely on professional accountants and auditors competent advice on a variety of business and taxation matters?	Strongly Agree	-	-
	Agree	13	17.5
	Neutral	7	9.5
	Disagree	48	64.9
	Strongly Disagree	6	8.1
	Total	74	100.0

Source: Survey outcomes, 2014

From the theoretical perspective, the need of an audit function can be explained by the agency theory, which denotes that due to a separation of ownership and control, the principal (owner) will monitor the activities of management through an audit function. However, the result shows that even if the compulsory audit requirement, many auditors have pointed out that the actual contribution of auditing towards its intended purposes is somehow limited. Furthermore, the public at large not depends on professional accountants and auditors advice on a variety of business and taxation matters. This can be witnessed that the practice of auditing has gained little perceived recognition from a large section of the public in Ethiopia.

**TABLE 7: COOPERATION AMONG AUDIT FIRMS**

Item	Response Category	Frequency	Percent
1. Do you agree that there is a strong cooperation among audit firms to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance, which would be expected in the future?	Strongly Agree	-	-
	Agree	6	8.1
	Neutral	7	9.5
	Disagree	34	45.9
	Strongly Disagree	27	36.5
	Total	74	100.0

Source: Survey outcomes, 2014

Another factor that can be considered as a challenge for the advancement of accounting profession in Ethiopia is lack of strong cooperation among private audit firms. 45.9 percent disagreed and 36.5 percent of respondents strongly disagreed about the existence of strong cooperation among audit firms to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance, which would be expected in the future (Table 7).

**TABLE 8: AUDIT FIRMS' COMPETITION IN THE AUDIT MARKET**

Items	Response Category	Frequency	Percent
1. Do you agree that obtaining audit clients through competitive bid led to unfair competition among audit firms in Ethiopia private sector audit-sub markets?	Strongly Agree	26	35.1
	Agree	35	47.3
	Neutral	-	-
	Disagree	13	17.6
	Strongly Disagree	-	-
	Total	74	100.0

Source: Survey outcomes, 2014

As observed from the responses obtained the majority of the respondents are agreed (47.3 percent), strongly agreed (35.1 percent) and the remaining disagreed (17.6 percent) about the features of obtaining audit client through competitive bid in Ethiopia private sector audit sub markets (Table 8). Supporting this Lemessa (1996) stated that in Ethiopia the State-owned Audit Service Corporation supplies external audit services to public enterprises and to private enterprise on competitive bids. This tends to make the market for external audit services rather thin. This thinness of the market is exhibited by the high level of competition among audit firms in the private sector.

Also, in response to the problems of price competition, OFAG assessed the audit firms and graded them as A, B, C, with A being the highest grade and C the lowest. Increased competition among audit firms, pressure to retain clients probably made it more difficult for audit partners to say 'no' to management of major clients. Audit firms may argue that their primary client is management. That is very few audit firms appreciate their professional obligation is to consider the well-being of investors. Accordingly, table 9 shows that majority of respondents (62.2 percent) agreed, 20.3 percent strongly agreed, 9.5 percent neutral, and 8.1 percent disagree about the bases of audit firm selection by audit clients. They indicate that it is in terms of positive personal audit-client relationship, grades given for audit firms, etc.

**TABLE 9: BASES OF AUDIT FIRM SELECTION**

Items	Response Category	Frequency	Percent
1. Do you believe that the specific choice of audit firms by audit client in Ethiopia is often attributed to positive personal auditor-client relationships and grade given (A, B, and C)?	Strongly Agree	15	20.3
	Agree	46	62.2
	Neutral	7	9.5
	Disagree	6	8.1
	Strongly Disagree	-	-
	Total	74	100.0

Source: Survey outcomes, 2014

For instance, assigning a grade for audit firms is not well received by most of the practitioners. In their view, as practitioners possessed practicing certificates from recognized accountancy bodies, such a grading was not meaningful and should have been left to the market. In addition, grading was also not regularly updated, which tended to worsen the problem. This could be one explanation of the apparently less well developed external audit market in the country to date (Mihret, et al, 2012).

The other major issue require due consideration is pursue of private audit firms alternative businesses that did not face the same challenges to audit assignment. This is the rapid expansion of consulting services.

**TABLE 10: AUDIT FIRMS' SHIFT TO NON AUDIT SERVICES**

Items	Response Category	Frequency	Percent
1. Do you believe that in the absence of effective competition in audit market, auditors tends to reduce the time they devote to an audit assignment and shift to non audit services?	Strongly Agree	13	17.6
	Agree	41	55.4
	Neutral	6	8.1
	Disagree	14	18.9
	Total	74	100.0

Source: Survey outcomes, 2014

From the total respondents, 55.4 percent agreed and 17.6 strongly agreed that private audit firms tends to reduce the time they devote to an audit assignment and shift to non audit services, in the absence of effective competition in audit market (Table 10). Supporting this, Healy and Williston (2005) under their study "The Challenges Facing Auditors and Analysts in U.S. Capital Markets" articulated that, even if there were no conflicts of interest between the two businesses (and he believe that there are), the rise of consulting was leading to a very significant change in the major audit firms. Their focus was on how to grow their consulting practice, rather than how to improve the quality of their audits.

Moreover, tendering has been specifically identified as a means by which independence is threatened (Moizer, 1994, p.20). In addition, the external audit market in most countries characterized by mandated market restriction that required non price competition and prohibited price competition among auditors. In Ethiopia, as per Lemessa (1996) the tendering requirement for auditors to secure clients tends to have caused price competition. This arguably puts auditors in competitive rather than cooperative positions.

**TABLE 11: AUDIT TENURE AND UNFAIR COMPETITION IN THE AUDIT MARKET**

Items	Response Category	Frequency	Percent
1. Do you believe that the existence of extended audit tenure aggravated unfair audit market competition in Ethiopia?	Strongly Agree	26	35.1
	Agree	41	55.4
	Neutral	-	-
	Disagree	7	9.5
	Strongly Disagree	-	-
	Total	74	100.0

Source: Survey outcomes, 2014

As indicated in the above table (table 11) 55.4 percent of the respondents agreed and 35.1 percent strongly agreed that they have a strong perception, the existence of extended audit tenure aggravated unfair audit market competition in the country. Supporting this, a long association between a corporation and an accounting firm may lead to such close identification of the accounting firm with the interests of its client's management that truly independent action by the accounting firm becomes difficult (U.S. Senate, 1976).

**ANALYSIS OF RESPONSES RELATED TO HUMAN RESOURCE**

Human capital is the most important and an essential asset for the auditing industry. An auditor has pointed this out by saying that the forming of an independent opinion whether the financial statements give a true and fair view is a process that requires much subjective judgment. Such a task needs to be performed by professional audit personnel. Therefore, "people" are always important for the success of an audit firm.

**TABLE 13: AVAILABILITY OF AUDIT PERSONNEL IN THE COUNTRY**

Item	Response Category	Frequency	Percent
1. Do you believe that sufficient quantities and qualified audit personnel (trained human resource) are available in the country?	Strongly Agree	-	-
	Agree	7	9.5
	Neutral	14	18.9
	Disagree	41	55.4
	Strongly Disagree	12	16.2
	Total	74	100.0

Source: Survey outcomes, 2014

In this respect, table 13 above shows that 55.4 percent and 16.2 percent of respondents disagreed and strongly disagreed respectively about the availability of sufficient quantities and qualified audit personnel (trained human resource) in the country. In addition, the quality of audit work depends on the people audit firms hire and programs designed to support their development. Accordingly, effective human capital strategies are critical to achieving sustained audit quality. This start with a rigorous recruiting program to bring in a mix of highly qualified candidates, at all levels, who have diverse backgrounds and skills.

**TABLE 14: COMPETITION FOR HUMAN RESOURCES**

Item	Response Category	Frequency	Percent
1. Do you believe that shortage of audit personnel has caused an unhealthy competition among audit firms and forced them to incur additional costs for young graduates?	Strongly Agree	6	8.1
	Agree	48	64.9
	Neutral	14	18.9
	Disagree	6	8.1
	Strongly Disagree	-	-
	Total	74	100.0

Source: Survey outcomes, 2014

However, regarding the competition among audit firms for human resource in the country 64.9 percent of respondents agreed for the existence an unhealthy competition as a result of audit personnel shortage in terms of quantity and quality and they forced to incur additional costs for young graduates (Table 14). This is similar to the findings of World Bank (2007) report on the observance of standards and codes (ROSC) Ethiopia. It states that the number of professional accountants in Ethiopia is low in relation to the size of the economy.

Furthermore, in the context of a changing environment, domestically and abroad, it is quite timely to discuss about the problems that accountants/auditors are facing and which are the new skills they should posses in order to survive in the face of an increasingly strong competition from outside consultants (Shkurti, et al, 2011). For instance, in the U.S., audit firms have hired graduates from the leading accounting programs. In contrast, in the U.K., the audit firms have hired talented young graduates at the leading universities, regardless of their field (liberal arts, sciences, etc.), and then provided the new hires with the needed accounting training once they are with the firm (Healy and Williston, 2005).

As can be seen from table 15 majority of (55.4 percent) of respondents have apposite perception about the decoupling between the knowledge base employed by the accounting practice and the one taught in universities and colleges in the country. Supporting this, Titard et al. (2004) suggested that, professional practice of auditing evolves to meet the changing needs of society, the accounting educational process needs to be continuously reevaluated so it can adequately prepare future practitioners for successful careers. It is said that auditing is a social function, and the role of auditors is subject to shift in accordance with the needs and demands of society (Porter, Simon and Hatherly, 2005).

**TABLE 15: EDUCATION OF ACCOUNTANTS/AUDITORS IN HIGHER EDUCATIONAL INSTITUTIONS**

Item	Response Category	Frequency	Percent
1. Do you believe that there is a decoupling between the knowledge base employed by the accounting practice and the one taught in universities and colleges in the country?	Strongly Agree	13	17.6
	Agree	41	55.4
	Neutral	13	17.6
	Disagree	7	9.5
	Strongly Disagree	-	-
	Total	74	100.0

Source: Survey outcomes, 2014

About compensation of auditors in the auditing profession, the majority of respondents indicated that they believed that auditing is a less attractive profession due to its long working hours and less rewarding remuneration in Ethiopia (45.9 percent agreed and 35.1 percent strongly agreed). However, there was clearly no universal support for such issues, with 18.9 percent of respondents stating that they disagreed with this view (Table 16).

**TABLE 16: COMPENSATION OF AUDIT PERSONNEL**

Item	Response Category	Frequency	Percent
1. Do you believe that auditing is a less attractive profession due to its long working hours and less rewarding remuneration?	Strongly Agree	26	35.1
	Agree	34	45.9
	Neutral	-	-
	Disagree	14	18.9
	Strongly Disagree	-	-
	Total	74	100.0
2. Do you believe that audit firms are facing a dangerous time in recruiting qualified auditing personnel as they are paid much better in other sectors or abroad?	Strongly Agree	20	27.0
	Agree	48	64.9
	Disagree	6	8.1
	Strongly Disagree	-	-
	Total	74	100.0

Source: Survey outcomes, 2014



In addition, as displayed under table 16 of audit practitioners surveyed, most of them felt that audit firms are facing a dangerous time in recruiting qualified auditing personnel as they are paid much better in other sector (like in financial sectors) or abroad (64.9 percent agreeing and 27 percent agreeing).

## FINDINGS

Analyses of the data collected confirm the following findings regarding the participants' awareness level and attitude, the suggested impeding factors and opportunities for private audit firms' activity in providing accounting and auditing service in the country.

### FINDINGS ABOUT REGULATORY PROCEDURES

- The study revealed that the availability of detailed regulations and professional standards in to which audit firms and all their staff must adhere, and which support audit qualities are in doubt. That is, there was lack of legislations with a brief description of responsibilities, appointment formalities and duties of audit firms in general and external auditors in particular in the country.
- The criteria's sated to scrutinize the applications of accountants and auditors, the issuance, renewal, suspension and cancellation of certificates of competence are not well defined in the regulatory procedures, properly implemented, and updated. Hence, to be an authorized auditor and accountant is a challenging process.
- It was found that absence of well organized strong national professional association result some challenges to works of private audit firms, in turn professional auditors and accountants in the country.
- The participants of the survey are not too much satisfied with the current regulatory body, Office of Federal Auditors General (OFAG). It is not able to fulfill properly responsibility of well organized professional accountancy associations in the country.
- There are no well defined systems with which those private audit firms who have registered outstanding audit service get rewards and the other way round in the country. That is, there is no a mechanism of making/holding liable those private audit firms breach laws, rules and regulations which govern the audit industry.

### FINDINGS ABOUT AUDIT MARKET

- One of the challenges facing audit practitioners can be low perceived value of the audit function. As it is confirmed by most of the participants, the audit function is viewed as a non-value adding activity and a waste of money and resources in the country.
- In relation to primary reasons why audit clients in the country requesting external audit service, it is found that invitation for an external audit service made only to satisfying the statutory and regulatory requirements. Thus, public at large not relies on professional accountants and auditors' competent advice on a variety of business and taxation matters.
- Another factor that can be considered as an opportunity for the advancement of accounting profession in Ethiopia is a strong cooperation among private audit firms. However, it is found that the existence of strong cooperation among audit firms to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance, which would be expected in the future is in question.
- In addition, as observed from the responses obtained the features of competitive bid in private sector audit sub markets results unfair competition among audit firms. Supporting this, the study also revealed that the bases of audit firm selection by audit clients, which is in terms of positive personal audit-client relationship, grades given for audit firms, etc.
- As per survey results and the interview held with key informants as a result of unfair competition in the audit market, private audit firms tends to reduce the time they devote to an audit assignment and shift to non audit services and maintain extended audit tenure.
- Besides, the flourishing private enterprises, progresses in establishing national accounting standards and stock market in the country may contribute positively towards the advancement of private audit firms and audit market.

### FINDINGS ABOUT HUMAN RESOURCES

- The participants in this study continue to indicate the other challenges to private audit firms operation in Ethiopia were related to human resources. In light of this, the study revealed that sufficient quantities and qualified audit personnel (trained human resource) supply were limited. Hence, there were strong competitions among audit firms for human resources.
- Private audit firms in the country also forced to incur additional costs for young graduates as a result of decoupling between the knowledge base employed by the accounting practice and the one taught in higher educational institutions in the country.
- The study also indicated that audit firms are facing a dangerous time in recruiting qualified auditing personnel as they are paid much better in other sector (like in banks, insurance, etc ) or abroad. Also, majority of respondents have perception that auditing is a less attractive profession due to its long working hours and less remuneration in Ethiopia. However, the major reason for less remuneration for auditors in Ethiopia is low audit fee subsequent to competitive bid in the audit market.
- Further, respondents also confirmed that private audit firms participated in "low balling" practice subsequent to unfair competition among audit firms. Therefore, they suggested that audit firms should soon come to an agreement for a standardized audit pricing.

## CONCLUSIONS

According to the findings, it is possible to conclude that unavailability of detailed regulations and professional standards, lack of legislations with a brief description of responsibilities, appointment formalities and duties of external auditors, lack of well defined, properly implemented, and updated criteria to scrutinize accountants and auditors, issuance, renewal, suspension and cancellation of certificates of competence are some of the challenges in the area of regulatory procedures to private audit firms currently constrained their operation and advancements. The results of this study also provide strong indicative evidence about challenges to private audit firms in general and external audit practitioners in particular in the sphere of external audit market. This includes low perceived value of the audit function, low demand for professional accountants and auditors' competent advice on a variety of business and taxation matters, lack of strong cooperation among private audit firms, unfair competition among audit firms in audit market.

On top of the above mentioned challenges, there are additional challenges like unavailability of sufficient quantities and qualified audit personnel (trained human resource), incurrence of additional costs for young graduates as a result of decoupling between the knowledge base employed by the accounting practice and the one taught in higher educational institutions, higher degree of audit personnel mobility in to another sector (like in banks, insurance, etc) or abroad and low audit fee pertaining to human resource in the country. Finally, the researcher is hopeful as these views will give an opportunity to think about some of the challenges both accountants and auditors face in today's business environment even though conclusions are consistent with many of previous research findings.

## RECOMMENDATIONS

### IMPLICATION TO REGULATORY PROCEDURES

Government regulations and proclamations since the 1920s have contributed to the development of accounting and auditing in Ethiopia. However, the findings of this study suggest that auditors in Ethiopia are facing many problems related to laws governing the activity of private audit firms. This study has shown the most important problem from the viewpoint of the audit practitioners such as;

- Unavailability of detailed regulations and professional standards
- Lack of legislations with a brief description of responsibilities, appointment formalities and duties of external auditors
- Lack of well defined, properly implemented, and updated criteria to scrutinize application of accountants and auditors, issuance, renewal, suspension and cancellation of certificates of competence.

Therefore, to ensure that the financial reporting and auditing rules applicable to different types and sizes of entity are appropriate to the needs of those entities, the users of their financial statements, and auditors, the current regulatory body (OFAG) and other accounting and auditing professional associations should work

together towards eliminating or minimizing problems in this regard. In order to achieve this objective, from time to time, the Office needs to evaluate the prevailing condition and ensure that all authorized auditors and accountants have uniform ethical standard in place and respect in discharging their duties to the public.

For instance they can develop a framework of professional ethics, which governs the provision of accounting and auditing services, aligning the normative (national) and legal framework in the area of financial reporting, accounting and auditing with the best international practices.

Establishing strong indigenous local professional accountancy associations in Ethiopia was attempted with little success. They have neither the capacity nor the legal basis to provide certification examinations that could serve as a prerequisite for licensing of practitioners. To this end, there needs to be a government commitment to provide professional associations with the legal authority to monitor, regulate, and grow the profession.

In addition, audit firms will need to work closely and cooperatively with regulators, like the key organizations involved in establishing international accounting and auditing standards and those involved in overseeing the international auditing profession to achieve the highest standards of performance.

#### **IMPLICATION TO AUDIT MARKET**

Since audit firms are both a business and a profession they need to ensure they strike the appropriate balance that serves the public interest. Accordingly, the results of this study also provide strong indicative evidence about challenges to private audit firms in the sphere of external audit market. This includes low perceived value of the audit function, low demand for professional accountants and auditors' competent advice on a variety of business and taxation matters, lack of strong cooperation among private audit firms, unfair competition among audit firms in audit market.

The situations of low perceived value of the audit function, low demand for professional accountants and auditors' competent advice on a variety of business and taxation matters may be improved through educating the users on the role and the duties of auditors, through better communication by private audit firms, regulatory bodies, professional associations, and academicians and by expanding the scope of the audit to meet market expectations.

Moreover, there is a prevalence of small and medium enterprises in Ethiopia, which is possibly associated with the less developed external audit market. Also there is little external audit requirement on most medium-sized private enterprises. Thus, through reforming financial reporting and audit requirements for these enterprises we can improve present low demand for professional accountants and auditors' service.

Furthermore, to overcome the problem of lack of strong cooperation among private audit firms and unfair competition in the audit market, there is a need for creating fair competition in the audit market because the former problem is as a result of unfair competition in the audit market. To achieve this one and the same auditor should not audit the books of accounts of the same client for longer time period, may be for not more than three years. That is private audit firms should avoid extended audit tenure. In addition, private audit firms should not provide both accounting and auditing services for one and the same client. This may result an occasion that organizations select auditors based on family or friends relationship and low balling, in turn unfair competition among audit firms.

#### **IMPLICATION TO HUMAN RESOURCES**

The diverse range of demands and impacts on the accounting and auditing profession is forcing a rethink of everything from training and development through to the type of people being recruited. In this respect, the current study identified unavailability of sufficient quantities and qualified audit personnel (trained human resource), incurrence of additional costs for young graduates as a result of decoupling between the knowledge base employed by the accounting practice and the one taught in higher educational institutions, higher degree of audit personnel mobility in to another sector (like in banks, insurance, etc) or abroad and low audit fee in the country.

Currently, to reduce problems of human resource availability in terms of quantity and quality in the country, the government increases the number of public higher educational institutions and frequently revises its educational policies and strategies. However, the critical problem is decoupling between the knowledge base employed by the accounting practice and the one taught in higher educational institutions. Thus, as a solution to this problem higher educational institutions (public and private) work to further develop their connections with the private audit firms, accounting and auditing regulatory bodies and accounting and auditing professional organizations. They also should work to bring together lecturers and representatives from private sector groups (audit firms, companies, etc.), professional associations or body such as the Accounting Society of Ethiopia, and representatives from the Ministry of Finance and Economic Development, Ministry of trade and industry, etc and enhance the dialogue between these groups.

Higher educational institutions also continue and increase their efforts to hire academic staffs with relevant practical experience to teach courses in accounting and auditing. Lecturers with knowledge of the application of accounting and auditing in the workplace can better prepare students for their roles as professional accountants and/or auditors. Besides, they need to take sabbaticals with company accounting departments, audit firms, and government bodies to refresh and enhance their knowledge of the practice of accounting and auditing.

Besides, higher educational institutions should update their curricula and use up-to-date teaching materials with good international practice to a level that will prepare graduates for the enhanced requirements in accounting and auditing. The curriculum should include accounting standards, auditing standards, and professional and business ethics. To support the new curriculum, the training institutions should be assisted with up-to-date textbooks, copies of accounting and auditing standards, and training-of-trainers programs on practical application of IFRS and ISA.

In addition to serving other industries, the private audit firms itself is a service industry in the business environment. To compete with each other within their own industry, audit firms need to provide continuing innovation and consistent investment in human resource development. Hence, professional association or body, nationally or internationally and OFAG should take the responsibilities in providing training for private audit firm staffs on ongoing, intense, specialized basis, and covering a wide variety of relevant subjects that extend beyond traditional accounting and auditing.

Moreover, audit clients in selecting an external auditor, particular consideration should be given to determining whether the fee quote is sufficient for the work required, that the work is to be undertaken by people with an appropriate level of seniority, skill and knowledge and whether the work proposed is sufficient to meet the company's needs and expectations. This may help to curve the problem of low audit fee, in turn higher degree of audit personnel mobility in to another sector (like in banks, insurance, etc) or abroad.

Generally, a strong financial reporting environment in the country requires active involvement of all stakeholders, including policy makers, investors, regulators, standard setters, corporate directors, company management and auditors in continuous reorganization and improvement of legal framework, institutions, accounting and auditing professions, as well as change in its business culture and education system. This can have a significant effect on the conduct of audits, the governance of the profession and the public's perceptions about the value of audits.

#### **SCOPE FOR FURTHER RESEARCH**

The study aims to assess social, economic, and regulatory settings in which private audit firms operate in order to identify those factors considered as challenges and opportunities in the perspective of external audit practitioners. For this purpose, taking in to account the constraints of resources (like financial and time) and for the sake of in depth and manageable work, the study confined within the realm of identifying the major challenges and opportunities for well operation of private audit firms in Ethiopia particularly, those audit firms working in the metropolis, Addis Ababa, taking into account its accessibility to the researcher.

That is, office of federal auditor's general definition of external auditor and private audit firms adopted, i.e. External auditor is a professional accountant conducting auditing and related services to the entity but not employed by the entity or by its manager and is independent of the persons who manage the entity. Whereas, private Audit firm: a sole practitioner or partnership of professional accountants, an entity that control such parties, and an entity controlled by such parties.

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